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No. 74-304

In the Supreme Court of the United States

OCTOBER TERM, 1974

RICHARD A. GORDON, ETC., PETITIONER

v.

NEW YORK STOCK EXCHANGE, INC., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

DOCUMENTARY APPENDIX TO THE BRIEF FOR THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

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S. 2693

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REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under terms and conditions hereafter provided by filing a registration statement in such form as the Commission may prescribe containing the undertakings, setting forth the information, and accompanied by the documents here below set forth:

(1) An undertaking to comply with, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon with any provision of this Act and any amendment thereto and any rule or regulation made or to be made by the Commission thereunder.

(2) Such data as to its organization, rules of procedure and membership, and other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange."

(4) An undertaking to furnish to the Commission copies of any amendments to the documents or instruments mentioned in clause (3) of this subsection forthwith upon their adoption.

(b) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations made by the Commission thereunder and that the rules of the exchange are just and adequate to ensure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(c) The Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying an application for registration as a national securities exchange within thirty days after the filing of the application, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of its filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(d) No registration shall be granted unless the rules of the exchange provide for the expulsion and suspension of a member for conduct or proceeding inconsistent with just and equitable principles of trade and declare that the violation of any provisions of this Act or any rule or regulation made by the Commission thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(e) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations of the Commission made thereunder and the applicable laws of the State in which it is located.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission and upon such terms as the Commission may fix, withdraw its registration.

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SEC. 18. * * *

(c) The authority above given the Commission shall include, among other things, authority to prescribe such rules and regulations for national securities exchanges, their members and persons transacting a business in securities through such members, in addition to those specifically provided in this Act, as it may deem necessary or appropriate in the public interest or for the protection of investors, and may by its rules and regulations more specifically define the form and procedure to be followed in carrying the provisions of this Act into effect. The Commission, among other things, may prescribe the time and method of making settlements, payments, and deliveries, the time and method of calculating margin requirements, and the time and method of closing out under-margined accounts. The Commission, among other things, may by rules and regulations prescribe rules for the conduct of business on exchanges, for the classification of members, for the election of officers and committees to ensure a fair representation of the membership, for the suspension, expulsion, or disciplining of members, for the listing or striking from listing of any security with right of appeal by the issuer to the Commission, for the reporting of transactions on the exchanges and upon tickers maintained by or with the consent of any exchange, including the method of reporting short sales, sales of securities in default in bankruptcy or receivership, and sales involving other special circumstances. The Commission may fix or prescribe the method of fixing uni-

form rates of commission, interests and other charges, may prescribe minimum units of trading, rules limiting the manner, method, and place of soliciting business, rules for odd-lot purchases and sales, rules regarding minimum deposits on marginal accounts, and rules limiting or prohibiting the registration or trading in any security within a specified period after the issuance or primary distribution thereof, prescribe rules governing the carrying of accounts and to prohibit fictitious or numbered accounts and require the disclosure of the real and beneficial owners thereof. The Commission shall have power to fix the hours of trading, and, if the public interest in its opinion so requires, summarily to suspend trading in any registered security or upon any registered exchange for a period not exceeding ninety days.

H.R. 7852

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SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under terms and conditions hereafter provided by filing a registration statement in such form as the Commission may prescribe containing the undertakings, setting forth the information, and accompanied by the documents here below set forth:

(1) An undertaking to comply with, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon with any provision of this Act and any amendment thereto and any rule or regulation made or to be made by the Commission thereunder.

(2) Such data as to its organization, rules of procedure and membership, and other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange."

(4) An undertaking to furnish to the Commission copies of any amenndents to the documents or instruments mentioned in clause (3) of this subsection forthwith upon their adoption.

(b) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations made by the Commission thereunder and that the rules of the exchange are just and adequate to ensure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(c) The Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying an application for registration as a national securities exchange within thirty days after the filing of the application, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of its filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(d) No registration shall be granted unless the rules of the exchange provide for the expulsion and suspension of a member for conduct or proceeding inconsistent with just and equitable principles of trade and declare that the violation of any provisions of this Act or any rule or regulation made by the Commission thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(e) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations of the Commission made thereunder and the applicable laws of the State in which it is located.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission and upon such terms as the Commission may fix, withdraw its registration.

* * * * *

SEC. 18. * * *

(c) The authority above given the Commission shall include, among other things, authority to prescribe such rules and regulations for national securities exchanges, their members and persons transacting a business in securities through such members, in addition to those specifically provided in this Act, as it may deem necessary or appropriate in the public interest or for the protection of investors, and may by its rules and regulations more specifically define the form and procedure to be followed in carrying the provisions of this Act into effect. The Commission, among other things, may prescribe the time and method of making settlements, payments, and deliveries, the time and method of calculating margin requirements, and the time and method of closing out under-margined accounts. The Commission, among other things, may by rules and regulations prescribe rules for the conduct of business on exchanges, for the classification of members, for the election of officers and committees to ensure a fair representation of the membership, for the suspension, expulsion, or disciplining of members, for the listing or striking from listing of any security with right of appeal by the issuer to the Commission, for the reporting of transactions on the exchanges and upon tickers maintained by or with the consent of any exchange, including the method of reporting short sales, sales of securities in default in bankruptcy or receivership, and sales involving other special circumstances. The Com-

mission may fix or prescribe the method of fixing uniform rates of commission, interests and other charges, may prescribe minimum units of trading, rules limiting the manner, method, and place of soliciting business, rules for odd-lot purchases and sales, rules regarding minimum deposits on marginal accounts, and rules limiting or prohibiting the registration or trading in any security within a specified period after the issuance of primary distribution thereof, prescribe rules governing the carrying of accounts and to prohibit fictitious or numbered accounts and require the disclosure of the real and beneficial owners thereof. The Commission shall have power to fix the hours of trading, and, if the public interest in its opinion so requires, summarily to suspend trading in any registered security or upon any registered exchange for a period not exceeding ninety days.

H.R. 8720

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REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section by filing a registration statement in such form as the Commission may prescribe containing the undertakings, setting forth the information, and accompanied by the documents below specified:

(1) An undertaking to comply, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon, with the provisions of this Act, and any amendment thereto and any rule or regulation made or to be made thereunder.

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange".

(4) An undertaking to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the violation of any provisions of this Act or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations made thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying an application for registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary, for the protection of investors, withdraw its registration.

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DISCIPLINARY POWERS OVER EXCHANGES

SEC. 18. The Commission is authorized—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw altogether the registration of a national securities exchange if the Commission finds that such exchange has violated any provision of this Act or of the rules and regulations thereunder or has failed to enforce, so far as is within its power, compliance therewith by a member or an issuer of a security registered thereon;

(2) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw altogether the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of this Act or the rules and regulations made thereunder;

(3) After appropriate notice and opportunity for hearing by order to suspend for a period not exceeding twelve months or to expel altogether from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this Act or the rules and regulations thereunder or has effected any transaction for any other person who as he has reason to believe is violating in respect of such transaction any provision of this Act or the rules and regulations thereunder.

(4) If in its opinion the public interest so requires, summarily to suspend trading in any registered security for a period not exceeding ten days, and with the approval of the President, summarily to suspend trading upon any registered exchange for a period not exceeding ninety days.

(5) If after appropriate request in writing to a national securities exchange that such exchange should effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested and that such changes are necessary for the protection of investors or for the insuring of fair dealing in securities traded in upon such exchange or for the insuring of fair administration of such exchange, to alter or add to the rules, regulations, and practices of such exchange in respect of such matters as the classification of members and the methods of election of officers and committees to insure a fair representation of the membership; the suspension, expulsion, or disciplining of members; safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; the listing or striking from listing of any security; hours of trading; the manner, method, and place of soliciting business; fictitious or numbered accounts; the time and method of making settlements, payments, and deliveries by members and customers; the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the

exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, in bankruptcy or receivership, and sales involving other special circumstances, the fixing of uniform rates of commission, interest and other charges; minimum units of trading; odd-lot purchases and sales, minimum deposits on margin accounts.

73D CONGRESS, 2D SESSION

S. 3420

[Report No. 792]

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REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 6. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members and by issuers whose securities are registered thereon, with the provisions of this Act, and any amendment thereto and any rule or regulation made or to be made thereunder;

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the violation of any provisions of this Act or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments

569-956—75——2

to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

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DISCIPLINARY POWERS OVER EXCHANGES

SEC. 19. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a national securities exchange if the Commission finds that such exchange has violated any provision of this Act or of the rules and regulations thereunder or has failed to enforce, so far as is within its power, compliance therewith by a member or by an issuer of a security registered thereon.

(2) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of this Act or the rules and regulations thereunder.

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this Act or the rules and regulations thereunder, or has effected any transaction for any other person who, he has reason to believe, is violating in respect of such

transaction any provision of this Act or the rules and regulations thereunder.

(4) And if in its opinion the public interest so requires, summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding ten days, or with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days.

(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with

the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters.

(c) The Commission is authorized and directed to make a study and investigation of the rules of national securities exchanges with respect to the classification of members, the methods of election of officers and committees to insure a fair representation of the membership, and the suspension, expulsion, and disciplining of members of such exchanges. The Commission shall report to the Congress on or before January 3, 1935, the results of its investigation, together with its recommendations.

H.R. 9323

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REGISTRATION OF NATIONAL SECURITIES EXCHANGES

SEC. 5. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing agreements, setting forth information, and accompanied by documents, as follows:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this Act, and any amendment thereto and any rule or regulation made or to be made thereunder;

(2) Such data as to its organization, rules of procedure, and membership, and such other information as the Commission may by rules and regulations require as being necessary or appropriate in the public interest or for the protection of investors;

(3) Copies of its constitution, articles of incorporation with all amendments thereto, and of its existing bylaws or rules or instruments corresponding thereto, whatever the name, which are hereinafter collectively referred to as the "rules of the exchange"; and

(4) An agreement to furnish to the Commission copies of any amendments to the rules of the exchange forthwith upon their adoption.

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the willful violation of any provisions of this Act or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this Act shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this Act and the rules and regulations thereunder and the applicable laws of the State in which it is located.

(d) If it appears to the Commission that the exchange applying for registration is so organized as to be able to comply with the provisions of this Act and the rules and regulations thereunder and that the rules of the exchange are just and adequate to insure fair dealing and to protect investors, the Commission shall cause such exchange to be registered as a national securities exchange.

(e) Within thirty days after the filing of the application, the Commission shall enter an order either granting or, after appropriate notice and opportunity for hearing, denying registration as a national securities exchange, unless the exchange applying for registration shall withdraw its application or consent to the Commission's deferring action on its application for a stated longer period after the date of filing. The filing with the Commission of an application for registration by an exchange shall be deemed to have taken place upon the receipt thereof. Amendments to an application may be made upon such terms as the Commission may prescribe.

(f) An exchange may, upon appropriate application in accordance with the rules and regulations of the Commission, and upon such terms as the Commission may deem necessary for the protection of investors, withdraw its registration.

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POWERS WITH RESPECT TO EXCHANGES AND SECURITIES

SEC. 18. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a national securities exchange if the Commission shall find that such exchange shall have violated any provision of this Act or of the rules and regulations thereunder or shall have failed to enforce, so far as is within its power, compliance therewith by a member.

(2) After appropriate notice and opportunity for hearing, by order to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to withdraw, the registration of a security if the Commission shall find that the issuer of such security has failed to comply with any provision of this Act or the rules and regulations thereunder.

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this Act or the rules and regulations thereunder, or has effected any transaction for any other person whom he has reason to believe is violating in respect

of such transaction any provision of this Act or the rules and regulations thereunder.

(4) And if in its opinion the public interest so requires, summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding ten days, or, with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days.

(b) The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) with respect to such matters as the classification of members and the methods of election of officers and committees to insure a fair representation of the membership; the suspension, expulsion, or disciplining of members; safeguards with respect to the financial responsibility of members and adequate provision against the evasion of financial responsibility through the use of corporate forms or special partnerships; the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; the listing or striking from listing of any security; the making available, at appropriate times

and upon reasonable terms and conditions, of the names and addresses of holders of listed securities; the manner, method, and place of soliciting business; fictitious or numbered accounts; the time and method of making settlements, payments, and deliveries, and of closing accounts; the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; the fixing of rates of commission, interest, listing, and other charges; minimum units of trading; odd-lot purchases and sales; minimum deposits on margin accounts; and similar matters.

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10206/June 6, 1973

The Securities and Exchange Commission announced that it has issued an order for the institution of an investigation and public investigatory hearing, pursuant to Section 21(a) of the Securities Exchange Act of 1934, to consider whether any changes should be made in the rules, policies, practices and procedures of one or more registered national securities exchanges respecting commission rate schedules.

The Commission announced that it had received on May 31, 1973 from the New York Stock Exchange, Inc. proposed revisions of that exchange's present commission rate schedule as contained in Article XV, Section 2 of its constitution and of its Rule 383 regarding service to small investors. The May 31 submission from that exchange and the Commission's order are attached hereto.

The Exchange informed the Commission that it expects to submit a documented economic report in support of the proposed revisions within a week. That report will be available to all interested persons in the Public Reference Section, Room 100 at the Commission's Headquarters Office, 500 North Capitol Street, N.W., Washington, D.C. 20459 and at each of the Commission's regional offices. Persons who

wish to obtain a copy of that report may do so by writing to Dr. William C. Freund, Vice President and Chief Economist, New York Stock Exchange, Inc., Eleven Wall Street, New York, New York 10005.

It is the Commission's understanding that the NYSE's proposal to increase commission charges by 15% on orders from $5,000 up to $300,000 contemplates a 15% increase on the entirety of such orders rather than only on the portion of orders which exceeds $5,000. It is also the Commission's understanding that the proposed amendment to Rule 383 would enable member firms to charge small investors commissions in excess of the proposed 10% increase on orders involving from $100 to $5,000 or the proposed 15% increase on orders involving more than $5,000, i.e., the existing fixed commission on small investors' orders would become, as in the case of larger investors' orders, a minimum commission. Further, it would permit member firms to negotiate separate charges for other services rendered, such as custodial fees.

The Commission will also consider such other rule proposals as may be received from exchanges and, where appropriate, will issue a supplemental release describing them.

The Commission also announced that a public investigatory hearing on stock exchange commission rate proposals will convene at 10 a.m. Monday, July 9, 1973 at the Commission's headquarters, 500 North Capitol Street, N.W., Washington, D.C., to receive testimony and other relevant data on the foregoing NYSE commission rate proposals. The Commission has requested representatives of the NYSE to appear at that time to present testimony and relevant data and invites all other interested persons to submit their views. Persons who wish to appear and present fac-

tual material at the hearing are invited to notify the hearing officer (William E. Toomey, Room 632, Securities and Exchange Commission, 500 North Capitol Street, N.W., Washington, D.C. 20549, (202) 755–1240) of that desire as soon as possible and not later than July 9, 1973.

Witnesses will be expected to file with the hearing officer 25 copies of their prepared statements 48 hours prior to their appearance and are invited to make available additional copies at the time of their appearance for the benefit of the press and other interested persons. Other interested persons may wish to transmit written submissions for inclusion in the record in lieu of personally appearing. They should file 25 copies thereof to facilitate examination of the record by all interested persons. Such material should be submitted not later than July 23, 1973. All other communications should be filed in triplicate.

By the Commission.

RONALD F. HUNT,
Secretary.

Securities and Exchange Commission,
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10383/September 11, 1973

CONCLUSIONS OF THE SECURITIES AND EXCHANGE COMMISSION WITH RESPECT TO COMMISSION RATES

The Securities and Exchange Commission announced today its unanimous conclusions concerning the commission rate proposals of both the New York Stock Exchange, Inc. ("NYSE") and the PBW Stock Exchange, Inc. ("PBW"), which were the subject of a recent public investigatory hearing.[1] Because of their importance to public investors, the national economy and the securities industry, the Comission has determined to announce its views immediately and publish shortly its letters to the exchanges embodying the reasons for its conclusions.

New York Stock Exchange Proposals

The NYSE has proposed to increase its fixed commission rates by 10 percent on orders ranging in size from $100 to $5,000, and by 15 percent on orders ranging in size from $5,001 to $300,000. The Commission today stated its conclusions that:

(1) It will not object if the NYSE immediately should adopt the proposed rate increase effective through March 31, 1974;

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[1] *See* Securities Exchange Act Release No. 10206 (June 6, 1973); Securities Exchange Act Release Nos. 10245 (June 28, 1973) and 10337 (Aug. 10, 1973).

(2) It will not object to the continuation of such a rate increase from April 1, 1974, through April 30, 1975, if the NYSE should first adopt rules, effective by or before April 1, 1974, which (a) eliminate that portion of NYSE Rule 383 prohibiting member firms from charging their customers commission rates exceeding the NYSE's commission rate schedule, and (b) permit, but do not require, member firms to provide less than a full range of brokerage services presently furnished customers in return for discounts of up to 10 percent from the commission rate schedule referred to in subparagraph (1), above;

(3) It will act promptly to terminate the fixing of commission rates by stock exchanges after April 30, 1975, if the stock exchanges do not adopt rule changes achieving that result; and

(4) It will not initiate in April, 1974, a break-point reduction below $300,000 respecting the portion of orders above which rates may be competitively determined.

PBW Stock Exchange Proposal

The PBW has proposed rule changes which would permit its members to offer investors a 14-day round-trip commission rate—that is, the grant of a 50 percent reduction in the commissions charged on the second transaction (either an offsetting sale or purchase) executed within 14 days of a purchase or a sale of the same security.[2] The Commission has concluded that it will object to the implementation of this round-trip commission rate proposal.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

[2] *See* Securities Exchange Act Release No. 10245 (June 28, 1973).

SECURITIES EXCHANGE ACT

SECURITIES EXCHANGE ACT OF 1934

Release No. 10560/December 14, 1973

The Securities and Exchange Commission today announced that it had sent the following letter to James J. Needham, Chairman of the Board of Directors of the New York Stock Exchange, Inc., setting forth the reasons for the conclusions articulated by the Commission on September 11th with respect to, among other things, the New York Stock Exchange's proposal to increase their schedule of commission rates.

The text of the letter was as follows:

DECEMBER 14, 1973.

MR. JAMES J. NEEDHAM,
Chairman, New York Stock Exchange, Inc.,
New York, N.Y.

DEAR MR. NEEDHAM: On September 11, 1973, the Commission announced its views concerning the commission rate proposals of both the New York Stock Exchange, Inc. ("NYSE") and the PBW Stock Exchange, Inc. ("PBW").[1] At that time, the Commission stated that, because of the importance of its views to public investors, the national economy and the securities industry, the Commission had determined to announce its views immediately and subsequently to indicate the bases for them. This letter sets

[1] Securities Exchange Act Release No. 10383 (Sept. 11, 1973).

forth the reasons for the Commission's conclusions with respect to your exchange's proposal to increase commission rates and with respect to the more fundamental issue of the manner in which the commission rates charged by members of all national securities exchanges should be determined in the future.[2]

THE CONCLUSIONS EXPRESSED BY THE COMMISSION

The Commission, as you know, expressed five basic conclusions with respect to commission rates on September 11th:

(1) The Commission would not object if any national securities exchange should amend its rules immediately to increase its schedule of fixed commission rates member firms are required to charge their customers by 10 percent on orders up to $5,000 and by 15 percent on orders of more than $5,000, as had been proposed by the NYSE, nor to the continuation of those rates through March 31, 1974;

(2) The Commission will not object to the further continuation of those increased rates during the period from April 1, 1974, through April 30, 1975, by any stock exchange that adopts rules, effective on or before April 1, 1974, which

(a) eliminate that portion of NYSE Rule 383, or any comparable rule of another exchange, prohibiting member firms from charging their customers com-

[2] Although the NYSE was the only national securities exchange which formally proposed amendments to its rules designed to effect increases in its schedule of commission rate charges on the portion of all securities orders handled by exchange members not exceeding $300,000, others of the registered securities exchanges had advised us of their intention to effect increases in their commission rate schedules comparable to those proposed by the NYSE.

mission rates exceeding the exchange's commission rate schedule, and

(b) permit, but do not require, member firms to provide less than a full range of brokerage services furnished customers in return for discounts of up to 10 percent from the then effective commission rate schedule;

(3) The Commission will act promptly to terminate the fixing of commission rates by national stock exchanges after April 30, 1975, if the stock exchanges do not, on their own initiative, adopt rule changes achieving that result in advance of that date;

(4) The Commission will not, in April, 1974, initiate a breakpoint reduction below $300,000 respecting the portion of orders above which the commission rates charged by their members may be competitively determined; and

(5) The Commission expressed its disagreement with the PBW's proposal to permit its members to reduce commission rates by 50 percent on the second transaction (either an offsetting sale or purchase) executed within 14 days of a prior purchase or sale of the same security by the same person.

As noted above,[3] this letter sets forth some of the policies considered and formulated by the Commission with respect to the first four of the foregoing five conclusions articulated by the Commission on September 11, 1973, concerning commission rate schedules of national securities exchanges.

THE NYSE'S PROPOSAL TO RAISE ITS SCHEDULE OF MEMBER COMMISSION RATE CHARGES

In order to place the conclusions articulated by the Commission on September 11th in proper perspective,

[3] See p. 1, *supra*.

it is important to recognize the nature and regulatory context of the action the NYSE proposed to take.

The NYSE submitted to the Commission a proposed amendment to its rules designed to effect an increase in the commissions its members are required to charge their customers for the portion of those transactions effected on the exchange that do not exceed $300,000. This proposal had, as you are aware, been preceded by earlier NYSE proposals also designed to modify, in some manner, its rules fixing the level and rate of commissions charged by its members.

While Congress, in enacting the Securities Exchange Act in 1934, did not explicitly authorize exchanges to fix the rates of commissions their members could charge, it did implicitly recognize that national securities exchanges might fix the commissions their members are required to charge if this practice did not meet with Commission disapproval.[4] As is also true of other powers which may reside with the exchanges by virtue of the Securities Exchange Act, any power to adopt rules fixing commission rate charges is not an unfettered authority. First, the exchanges were not authorized to fix commission charges which are unreasonable. And second, Section 19(b)(9) of the Securities Exchange Act vests pervasive residual authority in the Securities and Exchange Commission to alter, modify or amend any rules or practices of exchanges fixing rates of commission and other charges, including their elimination, notwithstanding the apparent concern of

[4] Section 6(c) of the Securities Exchange Act, 15 U.S.C. 78f(c), authorizes an exchange to adopt "any rule not inconsistent with . . ." the Act or applicable state law. And Section 19(b)(9) of the Act, 15 U.S.C. 78s(b)(9), authorizes the Commission to alter, modify or amend any existing exchange rules fixing commission rates.

some members of Congress in 1934 that the Commission might abuse its authority over exchange rules fixing commission rates by causing those rates to be set too low.[5]

But, to the extent any such rules are appropriate, the promulgation of rules concerning exchange-required fixed commission rates is a matter that Congress entrusted to the exchanges in the first instance, at least as long as the fixing of commission rates should be permitted.[6] The NYSE's rate proposal was submitted to us pursuant to Securities Exchange Act Rule 17a–8, 17 CFR 240.17a–8, generally requiring that advance notice be given to the Commission by any exchange proposing to amend its rules or practices. Our consideration of the NYSE's proposal was in the context of a determination whether the Commission should take any steps preliminary to the exercise of its authority concerning the effectiveness of the NYSE's proposed action.

We have considered the reasons why the NYSE proposed to increase the level of commission rates its members must charge, as well as the authority accorded to the exchanges by the Congress in 1934, and for the reasons enumerated below, we could not conclude that the NYSE's rate proposal was unreasonable.

In support of its proposal to raise commission rates, the NYSE provided the Commission with a substantial amount of information in support of the Ex-

[5] *See, e.g.*, the remarks of Congressman Pettengill during the House floor debates on the Securities Exchange Act:

"the Commission could fix rates of commission * * * so low that no broker could stay in business and thus [the Commission could] destroy his business * * *"

78 Cong. Rec. 8091 (1934).

[6] *See* pp. 8–10, *infra*.

change's position that member firms[7] have in the last 18 months experienced increases in the prices paid for goods and services.

The Exchange attempted to measure the effect of general inflationary forces and suggested specifically that substantial increases in the cost per transaction resulting from inflationary factors alone warranted a commission rate increase in the amount the Exchange had requested.[8]

The Commission recognizes that there has been some inflation in costs since the last increase effected

[7] Reference to the NYSE member firm community is not intended to indicate any failure to consider the circumstances of the members of other registered national securities exchanges. Indeed, the Commission has considered the fact that about 30 percent of all regional stock exchange member firms and over 80 percent of American Stock Exchange member firms also are NYSE member firms and believes that financial data concerning the NYSE firms for present purposes reasonably represents the financial experience of exchange members generally. And see note 2, *supra*.

[8] The Exchange submission included an attempt to measure the degree to which inflationary forces had increased the cost of brokerage firm payrolls and other goods and services purchased by member firms, proposing that the inflationary increase in costs experienced by member firms exceeded 17 percent between April, 1970, and April, 1973.

For example, exchange estimates of increases in the cost of specific items included a 19.1 percent increase in wages and salaries, a 55.9 percent increase in other employee benefits, a 15.2 percent increase in telephone and telegraph costs and an 8.7 percent increase in rental expenses.

The Commission is persuaded that significant cost increases have in fact occurred, whether or not the effect of such increases can be demonstrated to be in the precise degree suggested by the NYSE. Such increases, of course, must be, and in fact have been, considered along with other factors in determining whether or not the anticipated results of the proposed rate increase would be unreasonable.

by the Exchange in its schedule of commission rates and that Exchange members were not in a position to pass these increased costs on to their customers, largely because of the existing fixed rate schedule applicable to the vast bulk of orders executed on national securities exchanges. The Commission is also aware that, for a protracted period, there had been a substantial decline in the volume of transactions on exchanges which aggravated the effects of the cost increases that, in fact, had occurred.[9]

The Commission finds more significant, however, the Exchange's submission of information which clearly showed that its member firm community had been experiencing severe financial losses for a substantial period preceding the rate request.

Although the profitability of NYSE member firms carrying public customer accounts, in terms of pre-tax rate of return on capital and in terms of profit margin (pre-tax return as a percentage of gross revenue) were 18.9 percent and 12.8 percent, respectively, for the full year of 1972, rates of return in the last half of 1972 had declined below their historical average levels.[10] For the first seven months of 1973, NYSE

[9] In the second quarter of 1973, the value of trading on the NYSE had declined to a level 18 percent below the level of the same period in 1972. On the AMEX, the value of trading had declined 62 percent over the same period. In the first eight months of 1973, the value of trading was down 13.2 percent on the NYSE and 55.9 percent on the AMEX from the comparable period in 1972.

[10] These data are based upon the unconsolidated pre-tax profit figures reported by such firms on their Joint Regulatory Report, a monthly report the NYSE requires its members to file with it. Data are available on a consolidated basis for the years 1965 through 1972 from the annual income and expense reports filed by NYSE member firms carrying public customer accounts.

member firms doing a public business [11] as a group, suffered pre-tax losses of $195 million on total securities activity.

This decline in profitability in the last half of 1972 and loss condition in the first seven months of 1973 was apparently experienced by firms of all types, whether regional or national, and whether serving primarily large investors or primarily small investors. Not only was there an indication that roughly one-half of the NYSE firms which carried public customer accounts were suffering such severe losses, it was also clear that, if the same level of losses that had occurred in early 1973 continued, in less than twelve months seventy-six of these firms would be unable to meet the requisite net capital requirements for doing business.

Thus, on the basis of the financial experience of the industry in late 1972, and the first seven months of 1973, it did not appear that unreasonable rates of return were likely to result if the proposed rate increase were effected by the NYSE. On the other hand, without the rate increase, the continued deterioration in the capital positions of many member firms was foreseeable, with significant capital impairment and indirect, but consequential, harm to investors the likely result.

These circumstances principally motivated the Commission to raise no objection to the NYSE's rate increase for the period ending March 31, 1974.

THE MOVE TO UNFIXED COMMISSION RATES

The Commission's conclusion that it would be appropriate to require exchanges to eliminate fixed commission rates effective by April 30, 1975, of course, also had some influence on its conclusion not to object to the specific rate increase proposed by the NYSE.

[11] This includes both firms carrying public customer accounts and introducing firms.

The Commission has consistently taken the position that the long history of fixed rates argues against a precipitous elimination of the fixed rate system. It is appropriate, for the protection of investors and in the public interest, that stock exchange firms be given an opportunity to develop business strategies and adjust their operations to a competitive-rate environment. It is not appropriate to risk the possibility that undue haste might threaten the ability of the industry to fulfill its essential function of serving the needs of investors and corporations seeking capital from the public. The severe financial experience of the member firm community in the last half of 1972 and the first seven months of 1973 indicated that, without some form of rate increase, the ability of the industry to function would be impaired at the very time that it was expected to accomplish a transition to a competitive rate system (in a relatively short period of time), as well as the implementation of an extremely large number of other regulatory initiatives of a significant nature.[12]

The Commission does not, however, view this letter as the appropriate place to articulate definitively the reasons for its conclusion that the fixing of commission rates on securities transactions should be termi-

[12] In this context, it should be noted that Senator Harrison A. Williams, Jr., Chairman of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, in his July 27, 1973, statement submitted to the Commission in its recent hearings on the NYSE's rate proposal, suggested:

"* * * that the Commission used the present public proceeding to establish a blueprint for totally eliminating fixed brokerage rates. The Commission should announce a definite date for the end of price-fixing. The date should be sufficiently distant to allow the industry to adjust and plan adequately for a competitive environment, but it should be near enough to furnish the industry, the self-regulatory organizations and the Commission with the impetus to concentrate on and pursue measures

nated by April 30, 1975. Should it become necessary for the Commission to request Exchange action in the manner prescribed by Section 19(b) of the Securities Exchange Act, however, the Commission will set forth the basis upon which it is, at that time, requesting that specified action be taken.[13]

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which hold the promise of substantially reducing costs and improving the efficiency of broker-dealer operations. Suggestions for setting such a date 12 to 18 months hence, appear to me to be reasonable.

"In the event the Commission adopts the approach I am recommending, I believe it would be entirely appropriate for it to consider increasing fixed rates during the interim period. In light of the apparently severe profit squeeze in the industry such a rate increase may well be appropriate in the public interest."

[13] The Commission is aware of the present significance to the exchanges and their member firms of its view that fixed rates be abolished. For this reason, and in order to aid the exchanges in the formulation of appropriate rules, the exchanges should be aware of the following factors which have influenced the Commission's conclusion:

(1) The Commission is concerned that the heterogeneous nature of the brokerage industry militates against applying one fixed commission rate schedule to all elements in the industry.

(2) The Commission believes that, even without fixed minimum commission rates, the advantages of best execution for customer orders and the convenience and benefits, both to brokers and customers, of clearance and other services will cause trades to be brought to the exchange market. In any event, however, the Commission is satisfied that it has the authority necessary to assure that abandonment of exchange membership is not a means to evade the investor protection obligations incident to exchange membership.

(3) The Commisson has substantial doubt whether, in fact, small investors' transactions are subsidized by fixed commission charges to institutional investors, to the extent this is suggested as a rationale for the maintenance of fixed rates.

(4) The Commission is not persuaded, as some members of the industry apparently are, that fully competitive rates would result in large firms forcing small firms out of business; small regionally-located firms have disagreed.

PREDICATES FOR THE EXTENSION OF AN INCREASE IN FIXED COMMISSION RATES FROM APRIL, 1974 THROUGH APRIL, 1975

In its release issued on September 11th, the Commission indicated its view that it would not object to the further continuation—for the period from April 1, 1974, through April 30, 1975—of the increase in Commission rates proposed by the NYSE, if the NYSE should first effect changes in its rules designed to permit an interim period during which member firms could both (1) charge up to 10 percent less than the exchange-fixed minimum rate schedule if they should provide less than the full range of brokerage services generally being furnished at the present time, and (2) charge more than the exchange-fixed minimum rate schedule if they believe such increased charges are appropriate.

We understand through conversations with representatives of the exchanges and the member firm community that there is some question whether the foregoing proposal represents a workable opportunity for experimentation with limited price competition. We adhere, however, to our objective that the exchanges take steps to effect a meaningful experimental period prior to the introduction of a system of completely unfixed commission rates, even if it should take the form of a modification of our proposal or some other realistic alternative to it. We believe the exchanges and the member firm community should assume the initiative for developing a program fostering limited price competition during this period prior to the introduction of unfixed rates if there is a desire to retain the commission rate increase that was the subject of our September 11th release beyond April 1, 1974, and we request timely initiatives by the exchanges and

other interested persons to effect this aspect of the Commission's September 11th conclusions.

LACK OF ANY NEED FOR FURTHER REDUCTIONS IN THE BREAKPOINT AT WHICH MEMBER FIRMS MAY NEGOTIATE COMMISSION CHARGES

The Commission heretofore has encouraged a program of phased reductions of the breakpoint above which member firms may competitively determine commission rate charges. The volume discounts effected by the several exchanges since 1968 at the Commission's suggestion, as well as the phased introduction of competitively-determined rates on the portion of all stock exchange orders exceeding $300,000, certainly have effected necessary changes in the exchange-fixed commission rate structure which had created certain distortions in trading activities. These changes, however, were dispositive of a number of problems raised by larger firms or institutional investors. With the experiment in limited price competition that we hope all exchanges will effect, other investors, not merely those with large orders, will have the opportunity to react to the limited range of competitive rates this next step can provide. Accordingly, the Commission has concluded that it is not necessary to initiate an April, 1974, competitive rate breakpoint reduction to a point below $300,000.

For the reasons discussed above, the Commission believes that the rate increase of limited duration, and the phasing-in of competitively determined rates during the transitional period beginning by April 1, 1974, we envision, will assist in achieving a market structure and commission rates that will better serve the interests of investors, the broker-dealer community, stock exchanges and the issuers whose securities are

traded thereon. We expect, in the spirit of cooperation that is vital to the viability of any regulatory program, that your exchange, as well as the other national securities exchanges, will timely initiate rule changes consistent with the views expressed in this letter and in our release of September 11th, 1973. We look forward to working with the NYSE and all other interested persons to achieve these ends.

For the Commission,

RAY GARRETT, JR.,
Chairman.

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10670/March 7, 1974

ANNOUNCEMENT IN RESPONSE TO COMMISSION RATE PROPOSALS

The Commission announced today that it has responded to the New York Stock Exchange's proposals to initiate a program for limited price competition commencing April 1, 1974 on non-member orders involving up to $2,000 and to rescind existing prohibitions against charging, on orders involving more than $2,000, commissions in excess of the rates provided in stock exchange commission schedules. Further, the Commission responded to an NYSE request that minimum intra-member rates for floor brokerage and clearance functions be retained on orders not exceeding $2,000 and that a public investigation be made of the likely effects of introducing intra-member competitive rates for execution and clearance. The Commission stated that pending further study of, and solicitation of the public's views and comments on, whether current rules fixing intramember rate charges prevent an adequate experiment with limited price competition, it would not object to implementation, by April 1, 1974, of the limited unfixing of non-member rates described above. The text of the Commission's letter follows:

Mr. JAMES J. NEEDHAM,
Chairman, New York Stock Exchange, Inc.,
New York, N.Y.

DEAR MR. NEEDHAM: This is in response to the letters of the New York Stock Exchange ("NYSE"), dated February 7 and 21, 1974, which submitted to us, pursuant to Securities Exchange Act Rule 17a–8, 17 CFR 240.17a–8, proposed amendments to the NYSE's Constitution and Rules respecting commission rates. These letters responded to the statement in our letter of December 14, 1973, to the NYSE, that "the exchanges and the member firm community should assume the initiative for developing a program fostering limited price competition during "the period between April 1, 1974, and April 30, 1975. Accordingly, the NYSE's February 7th letter proposed amendments to Article XV of its Constitution, which would:

(1) provide for competitive non-member and intramember commission rates on all orders not exceeding $2,000; (2) rescind the prohibition now set forth in NYSE Rule 383 against charging commissions exceeding the existing exchange schedule of minimum rates applicable to orders exceeding $2,000; and (3) otherwise rescind NYSE Rule 383.

In its letter of February 21, the NYSE modified its original suggestions for Constitutional and Rule changes by deleting its proposed amendments respecting intramember rates for floor brokerage and clearance functions on orders not exceeding $2,000 (Sections 2(b) and 2(c) of Article XV of the NYSE Constitution). In this regard, the NYSE stated that no study has been made of the likely effects of intramember competitive rates and requested the Commission to conduct an investigation of this matter.

Pending further study of, and solicitation of the public's views and comments on, the question whether

the retention of your current rules fixing intramember rate charges for orders not exceeding $2,000 prevents the adequate experiment with limited price competition in which we previously indicated the exchanges should engage, we will not raise any objection if the NYSE should effect the rate proposals set forth in its letter of February 21. If the Commission determines, as a result of its study of the matter, that exchange experiments with limited price competition should be broadened to encompass intramember rates, we expect that you promptly will implement any necessary rule and consitutional changes.

The Commission appreciates the NYSE's timely efforts to begin a constructive experiment with limited price competition on April 1, 1974.

Sincerely,

RAY GARRETT, JR.,
Chairman.

Securities and Exchange Commission,
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10751/April 23, 1974

NOTICE OF PUBLIC HEARING ON INTRA-MEMBER COMMISSION RATE SCHEDULES OF REGISTERED NATIONAL SECURITIES EXCHANGES

The Securities and Exchange Commission today announced that a public investigatory hearing, ordered pursuant to the Commission's authority under the Securities Exchange Act of 1934 ("Exchange Act"), including, but not limited to, Exchange Act Section 21(a), 15 U.S.C. Section 78u(a), will be held beginning May 29, 1974 to receive oral and written comments, views and data concerning whether any changes should be made in the rules, policies, practices and procedures of registered national securities exchanges prescribing minimum rates of commission for business performed by one member for another ("intra-member rates"). The hearing will convene at 10 a.m., Wednesday, May 29, 1974, in Room 776 at the Commission's headquarters, 500 North Capitol Street, Washington, D.C. 20549.

In Exchange Act Release No. 10383 (September 11, 1973), the Commission announced its determination not to object to the proposal of the New York Stock Exchange, Inc. ("NYSE") to increase by 10 percent its fixed commission rates on non-member orders ranging in size from $100 to $5,000, and by 15 percent

on non-member orders ranging in size from $5,001 to $300,000. The Commission also announced in that Release that it would initiate action to terminate the fixing of commission rates by securities exchanges after April 30, 1975 if the exchanges have not amended their rules to effect such termination by that date and that, in order for the rate increase to continue from April 1, 1974 through April 30, 1975, the NYSE should adopt a program of rule changes, effective on or before April 1, 1974, which (a) eliminate that portion of NYSE Rule 383 prohibiting member firms from charging their customers commission rates exceeding the NYSE's commission rate schedule and (b) permit members to engage in a limited but adequate experiment in competitive commission rates. These conclusions were applied also to every exchange which adopted, and desired to continue in effect, the 10 percent and 15 percent commission rate increases. In Exchange Act Release No. 10560 (December 14, 1973), the Commission requested the exchanges to initiate timely development of such a program of rule changes.

In a letter dated February 7, 1974, the NYSE submitted to the Commission proposed amendments to its constitution and rules to rescind Rule 383, to provide for competitive commissions on both member and non-member orders of $2,000 or less and to rescind the prohibiton against charging commissions exceeding minimum rates. By letter dated February 21, 1974, the NYSE modified its proposal by withdrawing those of its proposed amendments which would have subjected intra-member commission rates to competition on orders of $2,000 or less.

In its letter, the NYSE also stated the following:

> The Exchange does not believe, however, that it is necessary to amend those provisions of the Constitution dealing with floor brokerage and clearance (Article XV, Sections 2(b) and 2(c)) in order to provide the experimentation sought by the Commission in its letter of December 14, 1973. No study has been made of the likely impact in the intra-member competitive rates, but quite clearly this impact might be unexpectedly severe on those members and member organizations which are largely dependent on these floor brokerage and clearance rates. A serious erosion in floor brokerage income could have a harmful impact on the essential market making function of specialists.
>
> The Board of Directors is not aware that there has been any meaningful accumulation of data on an industry wide basis as to the possible impact of negotiated intra-member rates. Because of the importance of this question with regard to the restructuring of the industry, the Board of Directors urges the Commission to conduct a public investigation of this matter pursuant to Section 21 of the Securities Exchange Act of 1934. This procedure would enable all interested parties to be heard and should provide the essential information needed to make an appropriate determination of this question. The Board urges that this procedure be initiated promptly so that it be completed well in advance of April 30, 1975.

In Securities Exchange Act Release No. 10670 (March 7, 1974), the Commission responded to the NYSE's modified proposals, stating:

> Pending further study of, and solicitation of the public's views and comments on, the question whether the retention of your current rules fixing intramember rate charges for orders not exceeding $2,000 prevents the adequate experiment with limited price competition in which we previously indicated the exchanges should engage, we will not raise any objection if the NYSE should effect the rate proposals set forth

in its letter of February 21. If the Commission determines, as a result of its study of the matter, that exchange experiments with limited price competition should be broadened to encompass intramember rates, we expect that you promptly will implement any necessary rule and constitutional changes.

Somewhat similar statements respecting intra-member rates were received from, and corresponding replies were sent to, other stock exchanges in connection with their proposals to implement, by April 1, 1974, the same limited experiment in competitive commission rates.

Interested persons who desire to appear or to submit written comments, views or data in this matter may wish to review materials submitted in the investigatory hearings conducted by the Commission in 1970 and 1971 concerning the reasonableness of, and the need for, minimum intra-member rates. These materials are contained in the following documents, which are available for inspection in the Commission's Public Reference Section, Room #6101, 1100 "L" Street, N.W., Washington, D.C. 20005 (copies of the hearing transcripts listed below may also be available in the Commission's regional offices):

Hearing Transcripts

In the matter of Commission Rate Schedules of Registered National Securities Exchanges:

File No. 4–144–1–17, July 20, 1970, Pages 5996–6037;
File No. 4–144–1–18, July 21, 1970, Pages 6188–6199 and Pages 6205–6208;
File No. 4–144–1–22, July 12, 1971, Pages 7279–7295;
File No. 4–144–1–22, July 13, 1971, Pages 7551–7586 and Pages 7594–7597; and

File No. 4–144–1–22, July 14, 1971, Pages 7599–7606 and Pages 7622–7625.

Exhibits

In the matter of Commission Rate Schedules of Registered National Securities Exchanges:

File No. 4–144–1–10 (NYSE). Exhibit 29–A—"Report on New Commission Rate Schedule" dated July 13, 1970, Pages 19–20.
File No. 4–144–1–14 (NYSE). Exhibit 71–1—"Report on New Minimum Commission Rate Schedule" dated July 12, 1971, Pages 21–26.

The purpose of the hearing is to gather comments, views and data concerning whether the initiation in the near future of a limited experiment in competitive intra-member rates of commission on orders not exceeding $2,000 would cause substantial and irreparable harm to floor brokers or to the market-making function of specialists, and whether it is necessary or appropriate in the public interest or for the protection of investors for exchanges to maintain any prescribed schedules of intra-member rates of commission. It will be necessary, if such schedules of intra-member rates are to be retained, for the Commission to have a basis upon which to judge the reasonableness of such rates. The following questions are intended to elicit such information. Persons who wish to offer oral or written statements for the record of the hearings are invited to comment on the following questions and other matters related to intra-member rates.

(1) What reason is there to conclude that an experiment until April 30, 1975 in competitive intra-member rates for orders not exceeding $2,000 would cause substantial and irreparable harm to floor brokers or to the market-making function of specialists? If members without their own floor brokers ("off-

floor members") are competitively disadvantaged as against vertically-integrated members (*i.e.*, members having their own floor brokers) by the present fixing of intra-member rates (see question (12)), will permitting fixed intra-member rates on orders not exceeding $2,000 during the period of experimentation with competitive non-member rates on such transactions, exacerbate the competitive disadvantage of off-floor members or, as between off-floor members and vertically-integrated members, cause statistically biased results respecting competitive non-member rates?

(2) Are intra-member rate schedules for (a) clearance services or (b) floor brokerage services necessary or appropriate for the protection of investors, or to insure fair dealing in securities traded upon an exchange, or to insure fair administration of an exchange?

(3) Assuming it is necessary or appropriate to have intra-member rate schedules for clearance functions, should such rates be higher than the clearing fees charged by a clearing corporation for direct mail clearance? Should they be different for orders effected for the member's own account than for orders effected by such member for other persons? (Compare Sections 2(b) and 4 of Art. XV of the NYSE Constitution.)

(4) Should intra-member rate schedules for execution be applicable to

(a) orders left with specialist (or, in the case of the Chicago Board Options Exchange, board brokers),

(b) services provided by a floor broker not acting as a specialist, or

(c) both?

(5) Should intra-member rate schedules for floor brokerage be different for different types of orders

(*e.g.*, market orders, limited price orders, percentage orders, not-held orders)?

(6) Should a member who provides execution and clearance services for other members and for non-member brokers be prohibited from lowering its prices if it believes such action is necessary to retain the business it receives from correspondents?

(7) Assuming it is necessary or appropriate for exchanges to retain intra-member rate schedules for floor brokerage, what standards should be used to determine their reasonableness? Please answer the following questions separately for (a) floor brokers not acting as specialists and (b) specialists, and explain whether your answers would differ depending on whether the intra-member rate schedules would provide for a minimum rate with no maximum, a fixed rate which is both a minimum and a maximum, or a maximum rate with no minimum:

(i) What expenses should be allowable in determining floor brokerage rates?

(ii) Should rate of return on investment be the standard used to determine the reasonableness of levels of profitability? If so, what should be the base of the rate of return, *i.e.*, equity capital or equity and debt capital?

(iii) What rate(s) of return should be allowed?

(iv) In order to provide excess floor brokerage capacity (if that is needed), must rates for floor brokerage be more than "economic cost-remunerative" (cover more than costs plus reasonable profit), or, absent such subsidy, would the number of available floor brokers increase quickly enough to accommodate sudden increases in demand? If excess capacity for floor brokerage services is needed, how much is needed and can it be supplied at lower cost by the automation of certain types of orders?

(v) Do intra-member rate schedules for floor brokerage which are more than economic cost-remunerative, or which compensate for maintaining excess capacity, unduly inhibit the automation of floor brokerage services?

(vi) Can costs and capital of non-specialist floor brokers be allocated among agency activities and their other activities? If so, how? If a member engages generally in the securities business in addition to providing floor brokerage services, should costs and capital be allocated between floor brokerage done for that member's own organization and that done for other member organizations?

(vii) Can costs and capital of specialists be allocated among specialists' broker functions, dealer functions and their other activities?

(viii) Should the standards for measuring the reasonableness of costs and rates of return differ in formulating intra-member rate schedules for specialists and for floor brokers?

(8) If exchanges are to retain schedules of intra-member rates of commission for specialists,

(a) should the specialist receive all or part of the intra-member rate for floor brokerage when he acts as broker with respect to an order left on his book? (Compare NYSE Constitution Art. XV, Section 2(c), which provides for payment of the full intra-member floor brokerage rate on that exchange to the specialist when he acts as broker for an order left with him, and American Stock Exchange, Inc. ("Amex") Constitution Art. VI, Section 2(c), which provides under similar circumstances for payment of approximately ¾ of the intra-member rate for floor brokerage to the specialist, leaving approximately ¼ for retention by the floor broker.)

(b) should the answer to (a) differ if the specialist acts as dealer with respect to such an order? (Compare the above NYSE and Amex constitutional provisions with Midwest Stock Exchange Article XXVIII, Rule 22.)

(9) Should intra-member rates paid to specialists on orders left with them be more than economic cost-remunerative in order to subsidize the specialist's dealer obligation? If so, can the amount of subsidy be calculated (and periodically adjusted) to do no more than subsidize the dealer obligation to the extent such a subsidy is required?

(10) (a) Assuming that the quality of specialists' dealer performance *can* be objectively evaluated,

(i) should floor brokerage income from the execution of orders left with all specialists on an exchange be pooled and then allocated by the exchange to specialists on the basis of performance?

(ii) if there is no pooling of floor brokerage income, should an exchange structure its schedule of rates so that a high-rated specialist would receive a larger portion of the floor brokerage income from orders left with him than he would if he were low-rated?

(iii) if there is no pooling of floor brokerage income and no differentiation in the amounts paid to specialists on the basis of their ratings, should an exchange reallocate stocks among specialists from time to time to reinforce high standards of specialist performance?

(iv) to what extent, if any, should any allocation of pooled floor brokerage income, or differentiation in amounts paid to specialists on the basis of their ratings, or periodic reallocation of stocks, take into account a specialist's profitability, or lack thereof, in addition to his dealer performance rating?

(v) to what extent, if any, should any allocation of pooled floor brokerage income, or differentiation in amounts paid to specialists on the basis of their ratings, or periodic reallocation of stocks be designed to achieve a subsidy of specialists' dealer activity in less profitable stocks?

(b) Could a prescribed intra-member rate for specialists' floor brokerage services which included an amount intended to subsidize the specialists' dealer functions meet the test of reasonableness if the quality of specialists' dealer performance *cannot* be objectively evaluated?

(11)(a) Does assignment by an exchange of the book to one specialist confer an undue competitive advantage upon him over other market makers on and off such exchange who would be willing to share the specialist's dealer obligations if they participated in his subsidy?

(b) If liquidity with depth is provided by competing market makers on or off an exchange (other than the exchange specialist) and the exchange retains intra-member rates for specialists which include a subsidy,

(i) should provision be made for such other market makers to receive a portion of the subsidy, and should the answer depend upon whether they supply such liquidity with depth for competitive reasons, or pursuant to their assumption of affirmative obligations; or

(ii) should each such market maker (including the specialist) have his own book and corresponding subsidy? If so, under what conditions?

(12) Do intra-member rates which are more than economic cost-remunerative place off-floor members at a competitive disadvantage as against vertically-integrated members? If intra-member rates on limit orders

left with specialists are not to be merely economic cost-remunerative but, as a matter of policy, are to include a subsidy for the specialist's market-making function, can intra-member rates for floor brokerage be the same for floor brokers as for specialists without competitively disadvantaging off-floor members?

(13) Assuming that the specialist's dealer function should be subsidized through intra-member rates on orders left with specialists and that excess floor brokerage capacity should be subsidized through separate intra-member rates for floor brokerage, will each of these assumed needs result in identical intra-member rates for specialists' agency sevices and for floor brokers' services? If the two have different costs or capital requirements, should exchange-mandated intra-member rates for agency services nevertheless be the same? If the intra-member were to be different for agency services provided by specialists and floor brokers, or were to be prescribed in the case of one but not the other, would this produce results inconsistent with the protection of investors, fair dealing or fair administration of the exchange?

(14) Various securities exchanges impose charges and fees, payable by one member to another member, for services other than traditional floor brokerage and clearance. For example, when a market-maker member on the PBW Stock Exchange, Inc. effects a principal transaction in one of the stocks in which he is registered with that exchange as an alternate specialist, he must pay 1¢ per share to the regular specialist in that stock (Rule 459). On the Midwest Stock Exchange, Incorporated a member (who is not a specialist) who deals as principal with another member is entitled to receive from that other member a fee equal to the rate of floor brokerage (Art. XXVIII, Rule 22). Are such required fees and charges necessary or appropri-

ate? What standards should be used to determine the reasonableness of such fees and charges?

Persons who wish to appear at the hearing are requested to notify the hearing officer, William E. Toomey, Room 632, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549, telephone number (202) 755–1240, as soon as possible.

Persons intending to appear should file 25 copies of the text of their prepared oral statements with the hearing officer 48 hours prior to their appearance and are invited to make additional copies of their statements available at the time of their appearance for the benefit of the press and all other interested persons.

Persons wishing to submit written statements for the Commission's consideration, in lieu of appearing personally, should file 25 copies thereof no later than June 14, 1974.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 10986/Aug. 27, 1974

ANNOUNCEMENT OF PLANS TO EFFECT THE ELIMINATION OF RULES OF NATIONAL STOCK EXCHANGES FIXING COMMISSION RATES

The Securities and Exchange Commission today announced that it plans promptly to initiate steps concerning the amendment, modification, alteration or repeal of the existing rules and practices of the national securities exchanges registered with the Commission pursuant to Section 6 of the Securities Exchange Act of 1934,[1] requiring exchange members to charge fixed rates of commission on securities transactions effected on exchanges.

The Commission is issuing this release in view of the questions that have been raised concerning the procedures to be followed by the Commission and the national securities exchanges in this regard.

On September 11, 1973,[2] the Commission announced its policy conclusion that exchange rules and practices requiring members to charge fixed rates of commission on securities transactions effected on an ex-

[1] 15 U.S.C. 78f.

[2] *See* Securities Exchange Act Release No. 10383.

change should be eliminated.[3] In its announcement, the Commission expressed its view that the elimination of such rules and practices should be effective no later than May 1, 1975.

In this context, the Commission today announced that, pursuant to the authority vested in it under the Securities Exchange Act, and particularly Sections 2, 6, 10, 11, 19 and 23 thereof,[4] it would send a letter to the president of each national stock exchange during September, 1974, asking them to alter, amend or modify existing exchange rules and practices which presently require, or have the effect of requiring, their members to charge fixed rates of commission, unless action on their part should make this unnecessary.

In the event that any or all of the exchanges decline to take such action voluntarily, the Commission will commence appropriate proceedings promptly to determine whether it should exercise its authority to effect modifications, alterations or amendments in existing exchange rules and practices relating to the fixing of commission rates.

The Commission's prior discussion of its views indicated its preference for voluntary exchange efforts to achieve a system of unfixed commission rates. Nevertheless, the Commission recognizes that there may be differences of view concerning whether, how and when to achieve such a system of unfixed commission rates on exchange transactions. For that reason, unless exchanges voluntarily take prompt steps to eliminate fixed commission rates, the Commission

[3] Further elaboration of the policy considerations underlying the Commission's determinations with respect to exchange rules and policies requiring members to charge fixed commission rates is set forth in Securities Exchange Act Release No. 10560 (Dec. 14, 1973).

[4] 15 U.S.C. 78b, 78f, 78j, 78k, 78s and 78w.

intends to afford all interested persons an opportunity to submit both written and oral data and views in order to facilitate a thorough consideration of this issue. In light of the prior study that has been given to the question of eliminating the present structure of fixed commission rates for securities transactions effected on exchanges,[5] however, it is the Commission's intention expeditiously to conclude any hearings which may be required.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

[5] Since 1968, the Commission and the Congress have expended a great deal of time and effort in studying the structure of commission rate charges on exchange-effected securities transactions. *See, e.g., In the Matter of SEC Rate Structure Investigation of National Securities Exchanges*, Commission File No. 4–144 (1968–1971); Subcommittee on Commerce and Finance of the House of Representatives Committee on Interstate and Foreign Commerce, 92d Cong., 1st and 2d Sess. *Securities Industry Study*, Parts 1–9 (1971–1972); Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, 92d Cong., 1st and 2d Sess., *Securities Industry Study* (1971–1972).

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 11019/September 19, 1974

ANNOUNCEMENT OF WRITTEN REQUESTS CONCERNING COMMISSION RATES SENT TO REGISTERED NATIONAL SECURITIES EXCHANGES

The Securities and Exchange Commission today announced that it had sent the following letter to all registered national securities exchanges:

DEAR [PRESIDENT OF EACH REGISTERED NATIONAL SECURITIES EXCHANGE]: As you are aware, the Commission, on September 11, 1973,[1] announced its policy conclusion that the fixing of commission rates by national securities exchanges should terminate after April 30, 1975. This conclusion followed ten years of special studies, Commission public investigatory hearings and policy statements, Congressional hearings and reports, studies by consultants for the New York Stock Exchange and publications by scholars concerning this practice.[2]

[1] *See* Securities Exchange Act Release No. 10383. The Commission's policy conclusions were discussed in more detail in a separate letter to the New York Stock Exchange, reprinted as Securities Exchange Act Release No. 10560 (Dec. 14, 1973).

[2] *See, e.g.*, Securities and Exchange Commission, *Institutional Investor Study Report*, H.R. Doc. No. 92–64, 92d Cong., 1st Sess. (1971); Securities and Exchange Commission, *Report of Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963); Securities and Exchange Commission, *Report on the Public Policy Implications of Investment*

The Commission, however, has consistently taken the position that the long history of fixed rates argued against a precipitate elimination of the fixed rate sys-

Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. (1966); and Wharton School of Finance and Commerce, *A Study of Mutual Funds*, H.R. Rep. No. 2274, 87th Cong., 2d Sess. (1962).

In the Matter of Intra-Member Commission Rate Schedules of Registered National Securities Exchanges, Securities and Exchange Commission File No. 4–171; *In the Matter of the Structure, Operation and Regulation of the Securities Markets*, Securities and Exchange Commission File No. 4–147; *In the Matter of Commission Rate Structure of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–144.

See Securities and Exchange Commission, *Policy Statement on the Structure of a Central Market System* (1973); and Securities and Exchange Commission, *Statement on the Future Structure of the Securities Markets* (1972).

See, e.g., Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 93d Cong., 1st Sess. *Report of the Securities Industry Study*, S. Doc. No. 93–13 (1973); Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 92d Cong., 2d Sess., *Report of the Securities Industry Study for the Period Ending February 4, 1972* (1972); *Hearings on Securities Industry Study Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 92d Cong., 1st Sess. (1972); Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 92d Cong., 1st and 2d Sess., *Report of the Securities Industry Study* (1971–1972).

National Economic Research Associates, Inc., *Stock Brokerage Commissions: The Development and Application of Standards of Reasonableness for Public Rates. A Report to the Cost and Revenue Committee of the New York Stock Exchange* (July 1970); National Economic Research Associates, Inc., *Reasonable Public Rates for Brokerage Commissions, A Report to the Cost and Revenue Committee of the New York Stock Exchange* (Feb. 1970).

See, e.g., Friend and Blume, *The Consequences of Competitive Commissions on the New York Stock Exchange* (1972).

tem and that it was appropriate, therefore, for the protection of investors and in the public interest, that exchange members be given an opportunity to develop business strategies for, and to adjust their operations to, an unfixed rate environment.

That opportunity has been provided. Commission schedules of exchanges have provided for volume discounts since December, 1968.[3] Commissions on portions of orders exceeding $500,000 have been competitively determined since April, 1971,[4] and those exceeding $300,000 have been competitively determined since April, 1972,[5] and, those with respect to nonmember commissions on orders of $2,000 or less, since April, 1974.[6]

Subsequent to the Commission's announcement of its policy conclusions on September 11, 1973, and in response to a request from the New York Stock Exchange, Inc., the Commission held a public investigatory hearing concerning fixed intramember rates on exchanges.[7] The Commission is not persuaded, on the basis of the data and views obtained as a result of that hearing and otherwise, that its policy conclusions of September 11, 1973, should not also be applicable to intramember rates. The Commission has also determined not to exercise its authority to require any further experimentation with unfixed intra-member rates prior to May 1, 1975. It will, however, welcome any initiative by any exchange to provide additional experimentation on floor brokerage rates prior to April 30, 1975.[8]

[3] *See* Securities Exchange Act Release Nos. 8324 (May 28, 1968), and 8399 (Sept. 4, 1968).

[4] *See* Securities Exchange Act Release Nos. 9105 (Mar. 11, 1971) and 9132 (Apr. 1, 1971).

[5] *See* Securities and Exchange Commission, *Statement on the Future Structure of the Securities Markets*, *supra* n. 2, at p. 16.

[6] *See* Securities Exchange Act Release No. 10560 (Dec. 14, 1973).

[7] *See In the Matter of Intra-Member Commission Rate Schedule of Registered National Securities Exchanges*, *supra* n. 2.

As a result of these studies and hearings, it presently appears to the Commission that it is necessary and appropriate (1) for the protection of investors, (2) to insure fair dealing in securities traded in upon national securities exchanges, and (3) to insure the fair administration of such exchanges, that the rules and practices of such exchanges that require, or have the effect of requiring, exchange members to charge any person fixed minimum rates of commission, should be eliminated. Accordingly, the Commission hereby formally requests, pursuant to the authority vested in it under the Securities Exchange Act of 1934, and particularly Sections 2, 6, 10, 11, 19 and 23 thereunder,[9] that you effect necessary changes in the Constitution, rules and practices of your exchange which presently require, or have the effect of requiring, any member of your exchange to charge any person any fixed commission rate, with such changes to be effective on or before May 1, 1975.

Because we believe the interests of public investors require the prompt implementation of the above-described Constitutional, rule and practice changes, we request that your Board of Directors approve the requested changes no later than November 1, 1974,

[8] The Commission will act promptly on any submission by the New York Stock Exchange of the proposal, discussed in the course of our Intra-Member Rate Hearings, n. 2, *supra*, to eliminate fixed minimum commission rates for clearance (Sections 2(b) and 4, Article XV, of the NYSE Constitution).

[9] 15 U.S.C. 78b, 78f, 78j, 78k, 78s and 78w.

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with such changes to become effective, after appropriate exchange procedures, not later than May 1, 1975. If the boards of directors of all of the national securities exchanges registered with the Commission do not take such action on or before November 1, 1974, the Commission will commence appropriate proceedings promptly to determine whether it should exercise its authority to alter or amend the Constitutions, rules and practices of such exchanges in the manner described above. In that event, as you previously have been advised,[10] the Commission will afford you and other interested persons an opportunity to submit both written and oral data and views in order to facilitate the Commission's consideration of whether to exercise its authority in this matter and whether to exercise it in the manner specified above. The procedures for that purpose would be specified prior to the commencement of any such proceeding.

For the Commission.

Sincerely,

RAY GARRETT, JR.,
Chairman.

The letters were sent to the American Stock Exchange, Inc., Boston Stock Exchange, Chicago Board Options Exchange, Inc., Chicago Board of Trade, Cincinnati Stock Exchange, Detroit Stock Exchange, Midwest Stock Exchange, Inc., National Stock Exchange, New York Stock Exchange, Inc., Pacific Stock Exchange, Inc., PBW Stock Exchange, Inc., Intermountain Stock Exchange and Spokane Stock Exchange.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

[10] *See* Securities Exchange Act Release No. 10986 (Aug. 27, 1974).

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 11073/October 24, 1974

PROPOSAL TO ADOPT SECURITIES EXCHANGE ACT RULES 19B–3 AND 10B–22 (4–176)

The Securities and Exchange Commission today released for public comment proposed Securities Exchange Act Rules 19b–3 and 10b–22. The rules would be adopted under the Securities Exchange Act of 1934 (the "Act"), and particularly Sections 2, 6, 10, 11, 19 and 23 thereunder, 15 U.S.C. 78b, 78f, 78j, 78k, 78s and 78w. In that connection, the Commission also announced that it would hold oral hearings beginning Tuesday, November 19, 1974, at 10 a.m., in Room 776 at the Commission's headquarters, 500 North Capitol Street, Washington, D.C. 20549.

Introduction

On September 19, 1974, the Commission requested national securities echanges to effect necessary changes in their constitutions, rules and practices so as to eliminate those elements that require, or have the effect of requiring, exchange members to charge any person any fixed rate of commission.[1] While the Commission has not received responses from all na-

[1] Securities Exchange Act Release No. 11019 (Sept. 19, 1974), 39 Fed. Reg. 35214 (Sept. 30, 1974).

tional securities exchanges, only one such exchange has indicated that it would comply with the Commission's request,[2] and three such exchanges have indicated that they do not intend to comply fully with the Commission's request.[3] Accordingly, the Commission has determined to publish for comment proposed Rule 19b–3 which would alter and supplement the rules of national securities exchanges by prohibiting national securities exchanges from adopting or retaining any rule of the exchange that requires, or from otherwise directly or indirectly requiring, members to charge

[2] The Intermountain Stock Exchange has so indicated; in addition, while the Cincinnati Stock Exchange has not yet responded to the Commission's request, it took action in July, 1974, to eliminate fixed intra-member rates.

[3] The American, Boston and New York Stock Exchanges have so indicated. The Amex has indicated that, after giving detailed consideration to the Commission's request and to the question of uniform versus negotiated commission rates, it (1) would seek a hearing to present the Amex's position on the need to retain uniform commission rates and (2) had determined that it could not accede voluntarily to the Commission's request. The Amex has accordingly requested an opportunity to submit to the Commission its written and oral views.

The NYSE has indicated that it believes that competitive rates without concurrent legislative and regulatory safeguards would ultimately be destructive of the auction market and not in the public interest. The NYSE has, therefore, indicated it would comply with the Commission's request insofar as it relates to public commission rates, but only if a combined program of legislation and regulation is enacted consistent with the intent of the NYSE's policy statement of March 1, 1973, which among other things, would require that all trades of listed securities be exposed to the flow of orders in an auction market prior to exposure to other markets. It has, however, declined to comply with the Commission's request insofar as it relates to floor brokerage commission rates. Since the combined program has not, in the NYSE's view, been enacted, the NYSE has also requested a hearing.

any person any fixed rate of commission for transactions executed on, or effected by use of the facilities of, such exchanges. In addition, Rule 19b–3 would require exchanges to provide in their rules that nothing therein or in the practices of exchanges shall be construed to require or permit members to agree or arrange, directly or indirectly, for the charging of fixed rates of commission. Rule 19b–3 would also relieve exchange members and their associated persons of the obligation to comply with any exchange rule covered by paragraph (a) of Rule 19b–3 regardless of whether the exchange had amended or repealed such rule; members and associated persons could also no longer rely on such an exchange rule.

In addition, the Commission has determined to publish for comment proposed Rule 10b–22 which would make it unlawful for any broker, dealer or member of any national securities exchange, directly or indirectly, to participate in any agreement or arrangement with another broker, dealer or member of any exchange with respect to the fixing of any amount to be charged to other persons in respect of transactions in securities executed on, or effected by using any facility of, such exchange. Proposed Rule 10b–22 would, however, not affect participation in agreements or arrangements in respect of transactions in securities which are exempted from Rule 10b–2 by paragraph (d) thereof or are made in compliance with the provisions of Rule 10b–7 or Rule 10b–8. Under section (c) of the proposed rule, the Commission, having due regard for the public interest and for the protection of investors, and in order to insure the maintenance of fair and honest markets, could grant exemptions, either upon written request or upon its own motion, and could impose upon any exemption so granted such terms and conditions as it deemed necessary or ap-

propriate in the public interest or for the protection of investors. Proposed Rule 10b–22 is intended to prevent circumvention of proposed Rule 19b–3 and, accordingly, would only be adopted if proposed Rule 19b–3 is adopted.

Commission concern with the operation of rules prescribing fixed commission rates for exchange transactions spans more than a decade of hearings and studies;[4] transitional changes in the historical fixed commission rate structure began in 1968[5] and have continued over a period of six years, reflecting the Commission's determination to devise gradual solutions which would be consistent with the protection of investors and the public interest; and the Commission's policy conclusions to act to terminate the fixing of commission rates have been a matter of public record for more than a year.[6] Nevertheless, before adopting rules to eliminate the fixing of commission rates, the Commission is undertaking to review all issues involved (including issues relating to the third market and such other issues as the exchanges and other interested persons believe should be covered) as well as to consider carefully any collateral consequences that might result from the elimination of fixed rates. Furthermore, it may be appropriate to consider

[4] Materials relating to such hearings and studies, as well as some of the other source materials which may prove useful to interested persons in submitting views, data and arguments with respect to the rules proposed today are listed, *infra*. The Commission will make available shortly a synopsis of action previously taken by the Commission relating to fixed commission rates on exchange transactions.

[5] *See* Securities Exchange Act Releases Nos. 8324 (May 28, 1968) and 8399 (Sept. 4, 1968).

[6] *See* Securities Exchange Act Release No. 10383 (Sept. 11, 1973), 38 Fed. Reg. 27243 (Oct. 1, 1973).

whether alternative or additional regulations should be provided under the Act.

Therefore, in addition to soliciting the submission by interested persons of written views, data and arguments, which should be submitted no later than December 10, 1974, the Commission will hold oral hearings beginning on November 19, 1974, to obtain oral presentations of views and data and arguments. The Commission will invite representatives of the national securities exchanges, member firms and other organizations in the securities industry as well as other interested persons to appear at the oral hearings. The Commission will welcome requests from other persons to appear and, subject to time limitations, will accommodate as many such persons as possible.

It is anticipated that the oral hearings will also prove a useful adjunct to the rulemaking proceeding. Nevertheless, in order to facilitate the widest possible public participation, copies of all written submissions, as well as transcripts of the oral hearings, will be made available in the Public Reference Room, 1100 L Street, N.W., Washington, D.C., and at each regional office of the Commission. Persons wishing to submit written views, data and arguments in respect of submissions made by others or in respect of views, data and arguments presented at the oral hearings may do so until December 24, 1974.

Proposed Rule 19b–3

The text of proposed Rule 19b–3 is as follows:

Rule 19b–3. Prohibiting Fixing of Rates of Commission by Exchanges

(a) Effective May 1, 1975, no national securities exchange ("exchange") shall adopt or retain any rule of the exchange that requires,

or shall otherwise, directly or indirectly, require its members, or any person associated with its members, to charge any person any fixed rate of commission for transactions executed on, or effected by the use of the facilities of, such exchange.

(b) Each exchange shall provide effective May 1, 1975, in its rules of the exchange that nothing therein or in its practices shall be construed to require or permit its members, or any person associated with its members, to agree or arrange, directly or indirectly, for the charging of fixed rates of commission for transactions executed on, or effected by the use of the facilities of, such exchange.

(c) On and after May 1, 1975, no member of any exchange, or person associated with any member, shall be required to comply with, or may rely on, the provisions of any rule of the exchange covered by paragraph (a) of this rule.

(d) As used in this rule, the term "rule of the exchange" refers to any provision of the constitution, articles of incorporation, bylaws or rules or instruments corresponding thereto, whatever the name, of the exchange.

If adopted, proposed Rule 19b–3 would by its terms become effective on May 1, 1975.

Proposed Rule 19b–3 is intended to reach all rules governing the fixing of rates of commission on exchange transactions. Thus, for example, in the case of the NYSE, the provisions of Article XV of the NYSE Constitution could not be retained after May 1, 1975; the rule specifically covers intra-member rates as well as rates charged to non-members. In addition, other rules, such as NYSE Rules 391, 392 and 393, would have to be amended by exchanges to eliminate provisions intended to preserve the fixed commission rate structure in connection with distributions outside of the normal pattern of exchange transactions. Proposed Rule 19b–3 covers any "rule of the exchange," which is defined to refer to any provision of the constitution, articles of incorporation, bylaws, or rules or instruments corresponding thereto, whatever the name, of the exchanges. Because of the long history of fixed commission rates, the Commission believes it would be appropriate, as provided by paragraph (b) of proposed Rule 19b–3, for exchanges to explicitly expunge the prior system by providing that nothing in their rules of the exchange or in their practices shall be construed to require or permit members to agree or arrange, directly or indirectly, for the charging of fixed rates of commission.

The Commission anticipates that, if proposed Rule 19b–3 is adopted, the exchanges will proceed promptly to arrange for their rules of the exchange to conform, effective May 1, 1975, if not sooner, to the requirements of Rule 19b–3 in compliance with Section 6 of the Act. Nevertheless, in the event that all necessary exchange action is not completed prior to May 1, 1975, paragraph (c) of proposed Rule 19b–3 makes clear that no member of any exchange, or person associated with a member, shall be required to comply with, or may rely on, the provisions of any rule of the exchange which paragraph (a) of proposed Rule 19b–3 would not permit an exchange to retain after May 1, 1975.

The rules of the exchanges have complex origins that will require careful examination in light of the adoption of Rule 19b–3. The Commission believes that exchanges should promptly undertake a comprehensive review of their rules in order to be in a position, if Rule 19b–3 is adopted, to undertake educational programs to acquaint their members with the provisions of any required new or revised rules as soon as possible.

Proposed Rule 10b–22

The text of proposed Rule 10b–22 is as follows:

Rule 10b–22. Prohibiting Fixing Rates of Commission by Brokers, Dealers or Members of Exchanges

(a) Except as provided in paragraphs (b) and (c) of this rule, it shall be unlawful for any broker, dealer or member of any national securities exchange ("exchange"), directly or indirectly, to participate in any agreement or arrangement with another broker, dealer or member of any exchange as to the fixing of any amount to be charged to other persons in respect of transactions in securities executed on, or effected by using any facility of, such exchange.

(b) Brokers, dealers and members of exchanges may participate in agreements or arrangements in respect of transactions in securities which are exempted from Rule 10b–2 by paragraph (d) thereof or are made in compliance with the provisions of Rule 10b–7 or Rule 10b–8.

(c) The Commission, having due regard for the public interest and for the protection of investors, and in order to insure the maintenance of fair and honest markets, may by order exempt from section (a) of this rule any agreement or arrangement, or agreements or arrangements, in respect of transactions in securities. The Commission may act either upon written request or upon its own motion and may impose upon any exemption such terms and conditions as it deems necessary or appropriate in the public interest or for the protection of investors.

Since proposed Rule 10b–22 would be intended to prevent any circumvention of the provisions of proposed Rule 19b–3, it would not be adopted if Rule 19b–3 were not adopted. If Rule 19b–3 is adopted,

Rule 10b–22 would not, if adopted, become effective prior to May 1, 1975.

Proposed Rule 10b–22 would prohibit brokers, dealers or members of national securities exchanges from participating, directly or indirectly, in any agreement or arrangement to fix any amount to be charged to other persons in respect of exchange transactions in securities. Since the prohibition is stated in terms of fixing of any "amount" to be charged to "other persons," it would make unlawful, for example, any agreement or arrangement with respect to either public commissions (that is, commissions charged to persons who are not members of an exchange) or intramember commissions (that is, commissions charged by members to other members).[7]

If plans currently in effect under Rule 10b–2 are appropriately amended to comply with the provisions of proposed Rule 19b–3 (and such amendments are declared effective pursuant to Rule 10b–2), proposed Rule 10b–22 would not prohibit any agreement or arrangement which is exempted from Rule 10b–2 by paragraph (d) thereof and by which any brokers, dealers or members of an exchange in effect agree on or arrange for an amount to be charged to their customers. Similarly, transactions permitted by Rules 10b–7 and 10b–8 would in all cases be excluded from the prohibition of proposed Rule 10b–22.

Because the Commission's responsibilities under the Act require that, among other things, it be sensitive to

[7] In addition to other remedies available to it, the Commission could, if proposed Rule 10b–22 is adopted, censure, deny registration to, suspend for a period not exceeding twelve months or revoke the registration of, any registered broker or dealer if the Commission determined that such broker or dealer, had willfully violated the provisions of proposed Rule 10b–22 and that such censure, denial, suspension or violation was in the public interest.

factors affecting the fairness, orderliness and efficiency of exchange markets, paragraph (c) of proposed Rule 10b–22 would permit the Commission to exempt certain agreements and arrangements. The Commission would only grant an exemption if, having due regard for the public interest and for the protection of investors, it concluded that the exemption would contribute to the maintenance of fair and honest markets. The Commission would welcome views on whether any specific exclusions from paragraph (a) of proposed Rule 10b–22 in addition, or as alternatives, to those set forth in paragraph (b) should be considered.

Source Materials

Set forth below is a list of some of the more important source materials relating to commission rate matters. While the list should not be assumed to be complete or exhaustive, it may prove useful to interested persons who wish to submit views, data and arguments with respect to the proposed rules.

Exchange Act Releases:

No. 8239 (Jan. 26, 1968) NYSE proposed rate structure changes.

No. 8324 (May 28, 1968) Order for institution of hearings on Commission rates.

No. 8399 (Sept. 4, 1968) Letter to NYSE regarding interim rate structure changes.

No. 8746 (Nov. 10, 1969) Letter regarding give-ups.

No. 8791 (Dec. 31, 1969) Issues covered in commission rate hearings.

No. 9007 (Oct. 22, 1970) Request to NYSE for new rate structure proposal.

No. 9079 (Feb. 11, 1971) Announcement of unfixing rates on orders in excess of $500,000.

No. 9096 (Mar. 4, 1971) Letter to NYSE regarding fixed intra-member rates.

No. 9105 (Mar. 11, 1971) Reaffirmance of competitive rates on orders in excess of $500,000.

No. 9132 (Apr. 1, 1971) Exchange of letters on commissions on institutional size orders.

No. 9148 (Apr. 14, 1971) Reaffirmance of $500,000 breakpoint.

No. 9950 (Jan. 16, 1973) Adoption of Rule 19b–2.

No. 10383 (Sept. 11, 1973) Policy conclusions with respect to, among other things, termination of fixed commission rates.

No. 10560 (Dec. 14, 1973) Letter to NYSE regarding commission rates generally.

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Chicago Board of Trade, Rules and Regulations, in particular Rules Ch. VIII.

Cincinnati Stock Exchange, Rules and By-Laws, in particular, Rules Sec. 54, By-Laws Secs. 1, 2, 3, 4.

Detroit Stock Exchange, Constitution and Rules, in particular, Constitution Art. XVIII, Rules Ch. VII.

Intermountain Stock Exchange, Constitution and Rules, in particular, Rules Art. XVI.[8]

Midwest Stock Exchange, Constitution and Rules, in particular Rules Art. XXVIII.

[8] As indicated in n. 2, the Intermountain Stock Exchange will amend Art. XVI, effective May 1, 1975.

National Stock Exchange, By-Laws and Rules, in particular, Rules Art. 3–18.

New York Stock Exchange, Constitution and Rules, in particular, Constitution Art. XV, Rules 365–387.

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All persons who wish to appear at the oral hearings should inform George A. Fitzsimmons, Secretary of the Commission, Room 892, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549, telephone number (202) 755–1160, not

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later than November 8, 1974. Persons intending to appear should file with the Secretary 30 copies of the text of any prepared statements not later than 48 hours prior to their appearance and are invited, at the time of their appearance, to make additional copies of their statements available for the benefit of the press and all other interested persons. Persons wishing to make written submissions of views, data and arguments should file 30 copies thereof with the Secretary no later than December 10, 1974. Copies of all submissions, as well as transcripts of the oral hearings, will be made available in the Public Reference Room, 1100 L Street, N.W., Washington, D.C., and at each regional office of the Commission. Persons wishing to submit written views, data or arguments in respect of submissions made by others or in respect of views, data and arguments presented at the oral hearings may do so until December 24, 1974. All submissions should refer to Securities and Exchange Commission File No. 4–176.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

Securities and Exchange Commission

Washington, D.C. 20549

SECURITIES EXCHANGE ACT OF 1934

Release No. 11093/November 8, 1974

FIXED COMMISSION RATES ON EXCHANGE TRANSACTIONS (FILE NO. 4–176)

On October 24, 1974, the Securities and Exchange Commission released for public comment proposed Securities Exchange Act Rules 19b–3 and 10b–22.[1] The Commission also announced that it would hold oral hearings, beginning on November 19, 1974, to obtain oral presentations of views, data and arguments and published a list of source materials to which interested persons could refer in submitting comments on the proposed rules. In addition, the Commission is today releasing the following staff synopsis relating to fixed commission rates on exchange transactions.

[1] Securities Exchange Act Release No. 11073, 39 Fed. Reg. 38396 (Oct. 31, 1974). Proposed Rule 19b–3 would, among other things, prohibit national securities exchanges from adopting or retaining any rule of the exchange that requires, or from otherwise directly or indirectly requiring, members to charge any person any fixed rate of commission for transactions executed on, or effected by use of any facility of, such exchanges. Proposed Rule 10b–22 would, among other things, make it unlawful for any broker, dealer or member of any national securities exchange, directly or indirectly, to participate in any agreement or arrangement with another broker, dealer or member of any exchange with respect to the fixing of any amount to be charged to other persons in respect of transactions in securities executed on, or effected by using any facility of, such exchange.

Introduction

From the enactment of the Securities Exchange Act in 1934 until 1968, rates of commission for transactions on exchanges were adjusted at infrequent intervals; for example, the commission rates of the New York Stock Exchange (the "NYSE") had been adjusted five times, or roughly once every seven years.[2] Beginning, however, with the *Wharton Report*[3] in 1962 and the *Special Study* in 1963, the exchange commission rates became the subject of intensive study, and, since 1968, the exchanges have made numerous changes in their commission rates, often in response to requests from the Commission. Since 1958, the NYSE's commission rates and related proposals have generally been followed by other exchanges and, accordingly, the following discusssion often refers to the NYSE's proposals and the Commission's reactions to them.

Commission Action Relating to Fixed Commission Rates

In January, 1968, the NYSE, in response to Commission concern with respect to the operation of the commission rate schedules then in effect, submitted to the Commission a proposal for certain revisions in the structure of its commission rate schedule. The proposal provided for volume discounts, economic access to the NYSE for non-member broker-dealers through a professional discount, limited recognition of "customer-directed give-ups"[4] and prohibitions on

[2] Securities and Exchange Commission, *Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963) (hereinafter referred to as the *Special Study*), pt. 2 at 329–333.

[3] Wharton School of Finance and Commerce, *A Study of Mutual Funds*, H.R. Rep. No. 2274, 87th Cong., 2d Sess. (1962).

[4] The customer-directed give-up was a payment by the executing broker of a part of the minimum commission it was required to charge its customer to other broker-dealers designated by the customer or his investment adviser. The amount of the payment was negotiated.

procedures then used by institutions to recapture commissions. The Commission's release with respect to that proposal described in some detail the commission rate schedule then in effect.[5] The release also described in some detail the give-up and reciprocal business practices which had been adopted in order to evade the fixed commission structure.[6]

[5] Securities Exchange Act Release No. 8239 (Jan. 26, 1968). The schedule then in effect prescribed a minimum commission rate, based on the value of the 100-share round lot, for each transaction regardless of size—the commission on an order for 10,000 shares was required to be 100 times the commission on an order for 100 shares. The *Institutional Investor Study Report* of the Securities and Exchange Commission, H.R. Doc. No. 92–64, 92d Cong., 1st Sess. (1971) (hereinafter referred to as the *Institutional Investor Study Report*), later accepted the conclusions of the July NERA Report prepared for the NYSE (see n. 13, *infra*) with respect to costs of executing transactions. It stated that "the average cost of handling a 1,000 share, a 10,000 share and a 100,000 share order of a $40 stock in 1969 was respectively, about 6, 42 and 377 times as great as the average cost of handling a 100 share order, yet the commission charged in 1968, was respectively, 10, 100 and 1,000 times the 100 share commission [footnote omitted]." *Institutional Investor Study Report*, vol. 4, at 2172.

[6] Normally, the customer's investment adviser directed give-ups to those brokers who had rendered it various services. The give-up was, thus, a means of utilizing the commission dollars paid by redirecting them to others in return for services often unrelated to the transaction that generated the commission. *See Special Study*, pt. 2 at 316; Securities Exchange Act Release No. 8239 (Jan. 26, 1968), 33 Fed. Reg. 2393 (Jan. 30, 1968). The *Institutional Investor Study Report* concluded in vol. 4, at 2199:

"The prevalence of the give-up demonstrated that NYSE firms specializing in execution and clearance for institutions were willing to perform this function for significantly less than

After receiving comments, the Commission instituted a public investigatory hearing to consider whether changes should be made in the rules, policies, practices and procedures of exchanges repecting commission rate structure since it appeared that the commission rate structure then in effect did not, in fact, provide fixed minimum commission charges on many exchange transactions. As an interim measure, the Commission requested adoption of a revised commission rate schedule which, among other things, prescribed reduced rates for that portion of an order involving round lots in excess of 400 shares or, alternatively, the elimination of requirements for minimum rates of commission on all orders in excess of $50,000.[7]

In the midst of the hearings the NYSE stated that it would adopt an interim commission rate schedule providing for volume discounts and that it would retain economic consultants to develop a cost-based commission rate schedule. In December, 1968, the NYSE and other exchanges adopted, as an interim commission rate schedule, a volume discount on orders over 1,000 shares and at the same time banned customer-directed give-ups, which the Commission had indicated were inconsistent with a premise that a fixed minimum commission schedule was necessary and appropriate to the effective and efficient operation of an exchange.[8]

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the commission imposed by the NYSE commission schedule and that other NYSE members not participating in the execution and clearance of portfolio orders were receiving commission dollars at the direction of the institution for services unrelated to the portfolio transactions, perhaps for example, for the sale of investment company shares."

[7] Securities Exchange Act Release No. 8324 (May 28, 1968).

[8] Securities Exchange Act Releases Nos. 8382 (Aug. 9, 1968) and 8399 (Sept. 4, 1968).

The economic study commissioned by the NYSE was scheduled to be based on data for the year 1969 and to be completed by June, 1970, and the Commission agreed to await completion of that study before resolving the basic question of whether rate-fixing by exchanges should be replaced by competition.[9]

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[9] Nevertheless, certain of the issues under consideration were recognized as having been sufficiently identified and explored at the hearings to allow the Commission to invite written submissions and to hear oral presentations in preparation for the resolution of those issues, in whole or in part. Therefore, a list of questions was published in order to give specific direction to views and comments on those issues. Securities Exchange Act Release No. 8791 (Dec. 31, 1969). In response to that invitation the Antitrust Division of the Department of Justice stated that, on the basis of its review of the hearings and study of the problem, it believed that a sound and reasonable method of transition could be and should be developed:

"A transition program would permit the Commission to institute competitive commissions gradually. It would be appropriate to begin with that part of securities trading in which effective and workable competition has already been evidenced, and where fixed rates have led to serious difficulties—i.e., the larger-volume transactions. The Commission could thus order the elimination of fixed rates on all transactions over a certain size and gradually reduce the specified size until all minimum rates had been eliminated. A gradual transition would also permit firms to adjust to the competitive system and would provide the Commission with an opportunity to take regulatory measures * * * to deal with any problems which may emerge.

"Accordingly, we recommend that the Commission should proceed to formulate a program of transition to competitive commissions, and to take appropriate action to put the program into effect under the Exchange Act, including Section 19(b)."

Memorandum of the United States Department of Justice on the Fixed Minimum Commission Rate Structure, January 17, 1969, at 194–195. *In the Matter of Commission Rate Structure of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–144 (1968–1971).

The preparation of the NYSE-commissioned study was subsequently accelerated; on February 12, 1970, the NYSE announced that its Board of Governors had reviewed a proposed new rate schedule approved by its Cost and Revenues Committee and authorized its presentation to the Commission. The NYSE presented to the Commission a study entitled "Reasonable Public Rates for Brokerage Commissions—A Report by National Economic Research Associates, Inc. to the Cost and Revenue Committee of the New York Stock Exchange" (the "February NERA Report"). The NYSE subsequently made clear, however, that its Board of Governors had not approved the proposed commission rate schedule set forth in the February NERA Report and that the February NERA Report was merely a study presented for discussion.[10]

In March, 1970, the NYSE proposed the imposition of an emergency 90-day surcharge on orders of 1,000 shares or less, to which the Commission did not raise any objection.[11] When the NYSE proposed to continue the surcharge for an additional 90 days, the Commission held public hearings on the proposal and determined not to raise any objection if the surcharge should be continued until such time as circumstances warranted its termination.[12]

The Commission thereafter reconvened hearings to analyze a new commission rate schedule proposed in June, 1970, by the NYSE. The NYSE proposal departed from a cost-based schedule, such as that set forth in the February NERA Report, by limiting

[10] NYSE Special Membership Bulletin, Feb. 12, 1970; NYSE Special Membership Bulletin, Feb. 19, 1970.

[11] Securities Exchange Act Release No. 8860 (Apr. 2, 1970).

[12] Securities Exchange Act Releases Nos. 8923 (July 2, 1970) and 8969 (Aug. 31, 1970).

increases on small orders and decreases on large orders called for in the original study.[13]

In October, 1970, the Commission concluded that the data submitted in support of the NYSE proposal did not provide a complete answer to the problems of commission rate structure, but that it would not be in the public interest to leave the subject indefinitely in abeyance. Accordingly, the Commission stated that it would not raise any objection if the proposed schedule were adopted with specified modifications and upon the understanding that specified steps would be taken to provide a better basis for the determination of commission rates. At the same time the Commission stated that it was of the opinion that fixed charges for portions of orders in excess of $100,000 seemed neither necessary nor appropriate and it further requested that a plan for reasonable economic access for nonmember broker-dealers be presented.[14]

[13] The NYSE submitted in support of its proposal a revised study entitled "Stock Brokerage Commissions, the Development and Application of Standards of Reasonableness for Public Rates, A Report by National Economic Research Associates, Inc. to the Cost and Revenues Committee of the New York Stock Exchange" (Jul. 1970) (the "July NERA Report"). The February NERA Report had proposed a 116.3 percent increase in the commission on an order involving 100 shares of a stock selling at $10 per share. The NYSE proposal in July called for a 50 percent commission increase for that order. For an order of 1,000 shares of a stock selling at $50 per share, the February NERA Report had proposed a 36.3 percent commission rate reduction. The July NYSE proposal called for a 10 percent commission increase for that order. For further comparisons, see Table XI–4 of the February NERA Report and Tables XI–3 and XII–3 of the July NERA Report.

[14] Securities Exchange Act Release No. 9007 (Oct. 22, 1970). Nevertheless, by the end of 1970 it appeared that the banning in 1968 of customer-directed give-ups and the simultaneous in-

By March, 1971, when the Commission transmitted the *Institutional Investor Study Report* to the Congress, it had concluded:

> The fixed minimum stock exchange commission on large orders has led to the growth of complex reciprocal relationships between, on the one hand, institutions (particularly mutual fund managers and banks) and, on the other, broker-dealers. This has had the effect of making commission rates for institutions negotiable but limiting the extent to which the ultimate investor rather than the money manager has benefited from such negotiation. As noted earlier, these relationships tend to aggravate potential conflicts of interest, to be anticompetitive in nature and to impede the development of a central market system for securities trading. Elimination of fixed commission rates for institutional size transactions should go some distance toward dealing with these problems.[15]

Nothing that has occurred since the submission of the *Institutional Investor Study Report* suggests any need to withdraw its perception of the regulatory problems of the fixed commission rate structure.

In April, 1971, at the direction of the Commission, exchanges provided that commissions on the portion of exchange orders involving $500,000 or more were to be competitively determined. In July, 1971, the Commission reconvened its commission rate hearings to receive testimony and other relevant data concerning a proposed rate structure based in part on the methodology

troduction of the volume discount had not solved the regulatory problems of fixed commission rate schedules. *See*, Address by Robert W. Haack before the Economic Club of New York, Nov. 17, 1970, quoted in *The New York Times*, Nov. 18, 1970, at 76, col. 8. *See also Institutional Investor Study Report*, vol. 4, at 2206.

[15] *Institutional Investor Study Report*, vol. 1, at xxii.

developed in the preceding year by the economic consultants engaged by the NYSE. The following September, the Commission advised the NYSE that it would not raise any objection to the new rate schedule if certain additional modifications to then prevailing commission-related practices were effected (including implementation of economic access for nonmember brokers at a discount of up to 40 percent from the public rate).[16]

Beginning in October, 1971, the Commission held hearings on the structure of the securities markets and, on February 2, 1972, issued its *Statement on the Future Structure of the Securities Markets* (the "*Market Structure Statement*"), which was based on those hearings as well as the earlier studies and hearings extending back over a decade.[17] The *Market Structure Statement* concluded that a reduction to $300,000 was indicated in the breakpoint above which commission rates on exchange transactions should be competitively determined. In reaching that conclusion, however, the *Market Structure Statement* noted that the securities industry had operated under fixed com-

[16] The Commission also indicated that the inability appropriately to allocate costs and revenues between brokerage and other activities engaged in by members had necessitated consideration of the proposal on the basis of the total financial experience of member firms and that it was continuing to study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000. *See* Securities Exchange Act Releases Nos. 9148 (Apr. 14, 1971) and 9351 (Sept. 24, 1971).

[17] The *Market Structure Statement* expressed the unanimous view of the then Commission (Chairman Casey and Commissioners Owens, Needham, Herlong and Loomis), although Commissioner Owens took a different view with respect to restrictions on transactions by institutionally affiliated brokerage firms for their institutional affiliates.

mission rates for a very long time and that it would therefore be appropriate to measure the effect of competitively determined commissions carefully, on a step-by-step basis. The Commission recognized the possible risk of a precipitate movement towards competitive rates, but concluded that that did not rule out moving towards competitive rates, at least on large orders, at a measured, deliberate pace.[18] In response to the Commission's conclusions, the breakpoint on fixed commission rate schedules was lowered to $300,000 in April, 1972.

Congressional Conclusions With Respect to Fixed Commission Rates

At the same time that exchanges, in response to requests from the Commission, began introducing competitively determined commission rates on large transactions, the Congress was studying the operation of the securities industry and securities markets of the United States. After reviewing arguments that the abolition of minimum commissions entailed greater risks than are necessary to achieve the objectives of a

[18] *Market Structure Statement* at 16. At about the same time, the *Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce* concluded, after looking at the business practices of the brokerage industry that had arisen over the preceding several years in response to the abolition of the customer-directed give-up: "Institutions and the brokerage community were able to split commissions by devices which achieved the same results as 'give-ups,' such as the 'four-way ticket'; the 'eight-way ticket'; the 'step-out'; the 'mirror transaction,' and other similar schemes which have been aptly described as 'Byzantine.'" *Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce*, H.R. Doc. No. 92–1519, 92nd Cong., 2d Sess., at 133 (1972) (hereinafter referred to as the *House Study*).

fair and economic level and structure of commission rates, an interim report issued by the Senate Subcommittee on Securities reached the same conclusions that the Commission had earlier reached. That report stated:

> While it is concededly impossible to predict the precise consequences of eliminating the fixed minimum commission rate system, it is equally impossible to predict the precise consequences of maintaining that system. There are risks in standing still as well as in moving forward. The experience of the securities industry over the past several years is hardly such as to inspire confidence in the adequacy of the present system. * * * To the extent that fixed commission rates failed to prevent, or even aggravated, these conditions, the relative "risks" of moving toward a new system are correspondingly lessened.
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> * * * * *
>
> On the basis of a review of these developments and the opposing arguments as to the relative merits of fixed and competitive rates, it is clear that the interests of the investing public, as well as the long-term health of the securities industry itself, require that stock exchange members be free to set their own commissions on transactions effected for their customers, subject to whatever anti-discrimination rules or other protections the SEC may deem appropriate.
>
> This does not, of course, mean that the fixing of rates should be eliminated in one step. Even the sharpest critics of the fixed rate system have recognized the need to permit the industry to adjust to rate competition in an orderly manner over a period of years. However, in order to begin making that adjustment, the industry needs, and is entitled to, a clear statement of

government policy that fully competitive rates are the goal toward which we are moving.[19]

The Report of the Senate Committee on Banking, Housing and Urban Affairs on S. 470 subsequently stated that the issues of institutional membership and fixed commission rates, while to some exent analytically distinct, were, as a practical mater, inseparable:[20]

> [A]lthough the committee believes that fully competitive rates are necessary and approprate for the long-term health of the securities industry, the development of a true central market system, and the protection and fair treatment of investors, there are serious difficulties vith any attempt by the Congress to set the preise date on which fixed rates are to be eliminatd.[21]

The Senate Committee decided, therefore, not to remove from the Commission its power to reguate

[19] *Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the Senate Committee on Banking, Housing and Urban Affairs* (For the Period Ended February 4, 1972), 92nd Cong., 2d Sess., at 57–60 (1972). *Cf.*, Securities Exchange Act Release No. 10383 (Sept. 11, 1973), 38 Fed. Reg. 27243 (Oct. 1, 1973), which provided that clear statement.

[20] The Commission was similarly persuaded that the isues were, in some respects, related but nevertheless determined that it was appropriate to take initial action on the matter of proper utilization of exchange memberships. It ultimately adopted Rule 19b–2 under the Act (Securities Exchange Act Release No. 9950 (Jan. 16, 1973), 38 Fed. Reg. 3901 (Feb. 8, 1973)) without, foreclosing the possibility that further changes migh be necessary or appropriate.

[21] *Regulation of Securities Trading by Members of National Securities Exchanges and the Sale of Investment Advisers of Registered Investment Companies, A Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 470*, Sen. Doc. No. 93–187, 93d Cong., 1st Sess., at 3 (1973).

exchange practices and set the pace for evolutionary changes, subject, of course, to any judicial review as might be appropriate. It noted that:

> So long as commission rates remain fixed and institutions, and all other investors, are unable to obtain brokerage services at prices which the forces of competition have determined to be reasonable, there will inevitably be efforts to circumvent the effect of fixed rates. These efforts have resulted and undoubtedly will continue to result in the creation of complex reciprocal practices which cause inefficient allocations of economic resources, exacerbate conflicts of interest, foster anticompetitive business practices and impede the development of a central market system for securities trading.[22]

The House Subcommittee on Commerce and Finance reached the same basic conclusions:

> The fixed commission rate system has led to heightened conflicts-of-interest and distortions in trading patterns. The economic incentive for these patterns should disappear with the implementation of a competitive rate system. [Footnote omitted.] Such a system will also allow investors to purchase only those brokerage services they desire and at prices which are reasonably related to cost. [Footnote omitted.]
>
> Other benefits will also accrue under a competitive system. Fixed minimum rates have tended to focus brokerage house executives' efforts on building sales, with little or no regard for costs. A competitive rate system will change this focus and will, we believe, benefit both the industry and its customers.
>
> * * * * *
>
> It is also clear from the record that the central market system, which appears to have the unqualified support of all segments of the securi-

[22] *Id.*

> ties industry and those who regulate it, can never be accomplished in an environment of fixed rates. * * * [T]he abolition of fixed minimum rates will facilitate the speedy development of a central market system.[23]

The House Subcommittee also recognized that there was general agreement that the securities industry had lived its whole life (insofar as exchange agency business was concerned) in a world of fixed prices and needed time to adjust to the world of competition and that a balance must be struck between the need of the industry to adjust and the rights of investors.[24]

The Commission's Policy Conclusion

In May, 1973, the NYSE proposed to increase rates by 15 percent on orders from $5,000 up to $300,000 and by 10 percent on orders involving from $100 to $5,000, and to remove the then existing prohibition, which had originated in 1970, on charging small investors more than the minimum commission. The Commission received comments on that proposal at a public hearing and, in September, 1973, determined not to raise any objection to the proposed increases or to their continuation through March 31, 1974.[25] The Commission further determined that it would not

[23] *House Study* at 141–142.

[24] *House Study* at 143.

[25] Securities Exchange Act Release No. 10383 (Sept. 11, 1973), 38 Fed. Reg. 27243 (Oct. 1, 1973). On the preceding March 1, however, the NYSE Board of Directors had adopted a resolution calling for a combined program of legislation and regulation concurrently eliminating fixed commission rates on all orders and establishing the requirement that all trades of listed securities be made on registered national securities exchanges operating under similar rules and regulations. NYSE *Policy Statement*, March 1, 1973.

On September 3, 1974, the NYSE proposed to increase rates again. As subsequently modified, the NYSE's proposal called for an increase of 8 percent on minimum rates of commission on transactions involving from $5,000 to $300,000. After receiving information with respect to the NYSE's proposal and holding a public hearing, the Commission determined not to invoke its jurisdiction to object to the NYSE's proposal. *See* Securities Exchange Act Release No. 11089 (Nov. 6, 1974).

raise any objection if those increased rates should be continued by the exchanges from April 1, 1974, to April 30, 1975, if rules were adopted (i) eliminating prohibitions on member firms' charging, on small orders, commission rates exceeding the minimum commission and (ii) permitting, but not requiring, member firms to compete to a limited extent on the basis of the price of brokerage services. The Commission also indicated that it would act promptly to terminate the fixing of commission rates after April 30, 1975, if the exchanges did not, on their own initiative, adopt rule changes achieving that result.

Subsequently, the NYSE proposed to provide for competitively determined commission rates on transactions involving less than $2,000. That proposal, as later modified by the NYSE to exclude intra-member rates (that is, rates paid by members to other members for floor brokerage and clearance), was adopted by the NYSE and other exchanges and became effective on April 1, 1974. In withdrawing its initial proposal, the NYSE Board of Directors stated that it did not believe it was necessary to amend the intra-member rate schedules as originally proposed in order to provide experimentation with competitively determined commission rates. The Commission then held a public hearing with respect to intra-member rates. In its opening statement at the hearings, the NYSE announced its willingness to abandon fixed intra-member commission rates for clearance.[26]

[26] Statement of James J. Needham, *In the Matter of Intra-Member Commission Rate Schedules of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–171 (1974), Transcript at 4–5.

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The Commission's Request and Subsequent Rule Proposal

Following a preliminary announcement on August 27, 1974,[27] of its plan to initiate steps concerning the alteration of the existing rules and practices of national securities exchanges requiring members to charge fixed rates of commission on securities transactions effected on exchanges, the Commission on September 19, 1974, made a formal request that national securities exchanges effect necessary changes in their constitutions, rules and practices so as to eliminate those elements that required, or had the effect of requiring, exchange members to charge any person any fixed rate of commission.[28] One national securities exchange has indicated that it would comply with the Commission's request; seven national securities exchanges have indicated that they would not comply voluntarily with the Commission's request.[29]

[27] Securities Exchange Act Release No. 10986.

[28] Securities Exchange Act Release No. 11019 (Sept. 19, 1974), 39 Fed. Reg. 35214 (Sept. 30, 1974). In addition, the Commission indicated that it had not been persuaded, on the basis of the data and views obtained at the public hearings on intra-member rates and otherwise, that its policy conclusions of September 11, 1973, should not also be applicable to intra-member rates.

[29] The Intermountain Stock Exchange has indicated that it would comply with the Commission's request. The American, Boston, Chicago Board Options, Cincinnati, Detroit, Midwest and New York Stock Exchanges have indicated that they would not comply.

The American Stock Exchange (the "Amex") has indicated that, after giving detailed consideration to the Commission's request and to the question of uniform versus negotiated commission rates, it (1) would seek a hearing to present the Amex's position on the need to retain uniform commission rates

Accordingly, in Securities Exchange Act Release No. 11073 (Oct. 24, 1974), 39 Fed. Reg. 38396 (Oct. 31,

and (2) had determined that it could not accede voluntarily to the Commission's request. The Amex has accordingly requested an opportunity to submit to the Commission its written and oral views.

The Chicago Board Options Exchange (the "CBOE") has indicated that it will continue its policy of conforming its rate structure basically to whatever may be the rate structure from time to time elsewhere. In accordance with that policy, the CBOE would have expected to file rule changes complying with the Commission's request if the other major exchanges had done so on or before November 1, 1974; but, since the other major exchanges have not done so, the CBOE will either submit its arguments or simply await the outcome of the Commission's proceedings. The CBOE believes that, with respect to its Board Brokers (who differ from the specialists on other exchanges in that Board Brokers do not have a dealer function), the proper solution is to require that each Board Broker post his rates and that such rates be uniform and non-discriminatory among customers. The CBOE will request an exception to Rule 19b–3 if and when other floor rates are required to be negotiated.

The Cincinnati Stock Exchange (the "CSE") has stated that it is of the opinion that to adopt rules permitting fully negotiated commission rates would not be in the public interest because to do so would only favor the large institutional investor and thus place a burden on individual customers, who are said to generate the most business for the majority of the CSE member firms. The CSE is also of the opinion that negotiated commissions would not be in its member firms' interest since many smaller firms could simply not compete with larger organizations; the inability to compete does not necessarily mean an inefficiently run operation, but rather that a small business is unable to face the stiff competition of big business. The CSE is, finally, of the opinion that negotiated commission rates would not be in its interest since, with the elimination of many of its member firms and the institutionalization of the market, the CSE would cease to exist. In July, 1974, the CSE did, however, eliminate fixed intra-member rates. The CSE believes that the demise of the auction market would be a great disservice to the general investing public.

1974), the Commission published proposed Rules 19b–3 and 10b–22 and scheduled oral hearings, commencing

The Detroit Stock Exchange has reviewed the results of an advisory vote of its membership and took no action with respect to amending its constitution to eliminate the fixed commission structure.

The Midwest Stock Exchange, Incorporated (the "MSE"), has reaffirmed its position, first announced in June, 1973, favoring elimination of fixed public rates. In so doing, the MSE stated that it recognized that public policy calls for the early ending of fixed public rates. At the same time, it stated, in light of a number of unfavorable circumstances or unresolved problems, the MSE believes that there is need for caution as to the effective date of the transition and hopes that the Commission will explore the present areas of concern and prospects for alleviating them before finally settling on a May 1, 1975, effective date. The MSE observed also that its June, 1973, position that a competitive rate environment is preferable to a regulated rate environment from all viewpoints is predicated on meeting concerns that (1) exchange membership for the purpose of handling affiliated business should not be permitted; (2) nation-wide clearance and depository facilities on an interfaced basis should be in existence so as to strengthen the industry operationally; and (3) there should be appropriate restructuring of operating and regulatory methods to fit the new environment in which exchange membership will no longer be defined in terms of preferred rate treatment. The MSE also indicated that it believes there may be new problems bearing on the appropriate effective date for complete termination of fixed public rates, including (1) fiduciary principles with respect to commissions and (2) a greatly deteriorated national and world economic situation, including monetary stress, oil and food situations and extremely high rates of inflation and money costs, all of which continue, it stated, to have serious direct impacts on the securities industry. The MSE noted further that it hoped that the hearings will provide an opportunity not only to explain further its belief that those concerns and problems should be taken into account in fixing an effective date for the transition to competitive public rates, but also to explore possibilities for their early resolution. In the case of floor rates, the MSE stated its belief that there should be further opportunity to explore not only the question of timing but also the substantive change itself, and it requested an opportunity to present its views on both questions at the oral hearings.

The NYSE has indicated it believes that competitive rates without concurrent legislative and regulatory safeguards would ultimately be destructive of the auction market and not in the public interest. The NYSE has therefore indicated it would comply with the Commission's request insofar as it relates to public commission rates, but only if a combined program of legislation and regulation is enacted consistent with the intent of the NYSE's policy statement of March 1, 1973, which, among other things, would require that all trades of listed securities be exposed to the flow of orders in an auction market prior to exposure to other markets. The NYSE has, however, declined to comply with the Commission's request insofar as it relates to floor brokerage commission rates. Since the combined program has not, in the NYSE's view, been enacted, the NYSE has also requested a hearing.

on November 19, 1974, as an adjunct to the rule-making proceeding.

Collateral Considerations

The foregoing background information is only a brief summary of more than a decade of Commission and Congressional study and Commission action with respect to fixed rates of commissions on exchange transactions. Not included is any review of related questions, such as the financial conditions of the brokerage industry and preservation of its ability to provide professional investment services in the context of changes in commission rate practices of long standing, the growth in institutional trading on exchange markets and the back-office crisis in the brokerage community in 1969 and 1970 and its aftermath.

Before institutional trading on exchanges had become significant, anomalies of commission rate sched-

ules did not create such acute regulatory problems. Rapid changes, however, occurred during the 1960's in patterns of exchange trading, and there was an increase in phenomena associated with institutional reaction to the fixed commission rate structure.[30] As, however, the Commission was preparing to reach conclusions on some aspects of rate matters in 1970, the brokerage industry began to encounter substantial difficulties. Those difficulties were the consequence of turmoil caused in large part by very active trading and the absence of a corresponding recognition on the part of the securities industry of the need to increase trained and experienced back-office employees or to develop operating procedures adequate for the expanded volume.[31]

In the particular settings before the Commission, it had the responsibility to determine the pace at which changes in fixed commission rate schedules should be introduced, to proceed cautiously, tempering long-term solutions in light of possibly dangerous short-term consequences, and to avoid undue risks to

[30] In 1961, institutional trading accounted for 38 percent of public volume, based on value, on the NYSE; in 1971, it accounted for 68 percent. NYSE, *1974 Fact Book* 55 (1974). The NYSE has testified that the trend was continuing. *Hearings Before the Subcommittee on Financial Markets of the Senate Committee on Finance*, 93d Cong., 1st Sess., pt. 1, at 104–105 (1973).

[31] *See* Securities Exchange Act Release No. 8791 (Dec. 31, 1969), in which the Commission solicited views and comments concerning the fixing of commission rates. For a description of the financial and operational crisis that afflicted the brokerage community in the late 1960's, see *Securities Industry Study, Report of the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs*, S. Doc. No. 93–13 93d Cong., 1st Sess. 28–29 (1973).

investor protection and the public interest.[32] Indeed, even under fixed minimum commission rates established by the exchanges, the brokerage industry has experienced substantial structural realignments.[33]

[32] Balancing competitive principles against other desirable ends cannot be done outside a regulated environment—the Supreme Court has specifically noted, "it is not for the courts to determine whether in particular settings price-fixing serves an honorable or worthy end." *United States* v. *National Ass'n of Real Estate Boards*, 339 U.S. 435, 489 (1950). For a definitive discussion of the Commission's authority under Section 19(b) of the Act, *see* Securities Exchange Act Release No. 9950, "Adoption of Rule 19b–2 under the Securities Exchange Act of 1934 Governing Utilization of Exchange Membership for Public Purposes" (Jan. 16, 1973), 38 Fed. Reg. 3901 (Feb. 8, 1973). *See also PBW Stock Exchange* v. *Securities and Exchange Commission*, 485 F. 2d 718 (3d Cir. 1973), *cert. denied*, 40 L. Ed. 2d 558 (1974). In discussing the Commission's action with respect to commission's rate review, including the policy conclusion of September 11, 1973, to terminate the fixing of commission rates, the Second Circuit recognized that measured withdrawal of the fixed commission rate structure could avoid the loss of investor funds. *Gordon* v. *NYSE*, 498 F. 2d 1303 (2d Cir.), *petition for cert. filed*, 43 U.S.L.W. 3148 (U.S. Sept. 19, 1974) (No. 74–304).

[33] A general trend toward fewer NYSE member organizations has been apparent for more than a decade. In 1961 there were 681 NYSE member organizations; that number has declined in each subsequent year but one and stood at 523 at the end of 1973. On the other hand, at the end of 1973, the number of offices operated by NYSE members remained above the corresponding number in 1961, as did the number of registered representatives. *See* NYSE, *1974 Fact Book*, 84 (1974). The NYSE has suggested that there has been a further decline in number of member firms (to 512) and branch offices (a decline of approximately six percent) during the first nine months of 1974. *In the Matter of Commission Rate Schedules of Registered National Securities Exchanges*, NYSE Exhibit 7, Securities and Exchange Commission File No. 4–174 (1974). At the end of the 1960's, there was a serious shift in the general trend towards fewer member organizations. Several major

Developments since 1970, such as implementation of the Securities Investor Protection Act of 1970,[34] revision of financial responsibility rules,[35] implementation of new rules with respect to custody of customer funds and securities [36] and improved surveillance procedures [37] have made it possible for the Commission to require changes in commission rate practices without unnecessary risk to investor protection or the public interest. As noted above, the Commission has required the introduction of competitively determined commission rates on both large and small transactions. The brokerage community has thus had an opportunity to develop methods of doing business in the new environment, and there has been an opportunity for the establishment of reasonable commission rates through the interaction of competitive forces.

brokerage firms collapsed, exhausting the trust funds established by the exchanges to protect customers of member firms. Securities and Exchange Commission, *Study of Unsafe and Unsound Practices of Broker-Dealers*, H.R. Doc. No. 92-231, 92d Cong., 1st Sess. 16 (1971).

[34] 15 U.S.C. 78aaa *et seq.* The Securities Investor Protection Corporation, established by the Securities Investor Protection Act, had by the end of 1973, placed 94 firms in liquidation. Of that 94, six liquidations had been completed and in 78 others substantially all customer claims had been satisfied. Securities Investor Protection Corporation, *Third Annual Report 1973*, at 1 (1974). *See also The Wall Street Journal*, Nov. 7, 1974, at 4, col. 1.

[35] *Compare* NYSE Rule 325 as in effect until 1970 *with* such rule as in effect subsequently.

[36] Rule 15c3-3 under the Securities Exchange Act of 1934, 17 CFR 240.15c3-3.

[37] *See*, Securities Investor Protection Corporation, *Third Annual Report 1973*, at 16-17 (1974).

The Current Perception of Fixed Commission Rates under the Act

The history of fixed commission rates for exchange-executed transactions, of course, dates back to the Buttonwood Tree agreement in 1792. Fixed minimum rates have thus had a long history. This synopsis is not intended to indicate, and, indeed, there is no need to indicate, that the maintenance of a fixed rate system for exchange transactions has always been inappropriate.[38] Nevertheless, the foregoing review of the operation of the fixed minimum commission rate structure since the 1960's, particularly in light of the dramatic increase in trading by institutional investors, has demonstrated that the fixed rate structure, both in the 1960's and as subsequently modified, was unsuited to the new demands upon the exchange markets, particularly the influx of institutional orders.

This synopsis relating to fixed commission rates on exchange transactions is, of course, not the appropriate vehicle for coming to final determinations with respect to the reasons why proposed Securities Exchange Act Rules 19b-3 and 10b-22 should be adopted.[39] Nevertheless, based upon the data available at present, and subject to any further information,

[38] Indeed, in 1934, the Congress itself, in drafting the Act, recognized that fixed commission rates might be necessary or appropriate under particular circumstances and delegated to the Commission pervasive authority not only to eliminate a fixed rate system but, alternatively, to regulate a system of fixed rates on exchanges so long as it appeared to the Commission to be necessary or appropriate to do so.

[39] The hearings scheduled to commence on November 19, 1974, complemented by the prior hearings and studies discussed above and the other materials listed in Securities Exchange Act Release No. 11073 (Oct. 24, 1974), 39 Fed. Reg. 38396 (Oct. 31, 1974), will assist the Commission in determining whether to adopt those rules or take some other appropriate action.

data and views which may be adduced at the hearings on proposed Rules 19b–3 and 10b–22, it should be noted that the Commission's constant review and analysis of the market structure and functioning, particularly since the 1960's, has contributed to a conclusion by both the Commission and knowledgeable committees and subcommittees of the Congress that the fixed rate system, even as modified over the last decade, has heightened conflicts of interest and distorted trading patterns, has seriously disadvantaged various classes of public investors and has tended to work against the development of a meaningful central market system for listed securities.[40]

Furthermore, there do not appear to be countervailing considerations which might relate to the public interest or the protection of investors that appear sufficiently significant to stay the Commission from the proposed implementation of its policy conclusion.[41]

[40] *See* pp. 2–23, *supra*.

[41] For example, *see* the *House Study*, which concurred "with the [then] president of the New York Stock Exchange that 'the fixed minimum commission rate * * * has itself been the greatest fragmenter of the market' [footnote omitted] and with his view that with fully negotiated rates business will be done on the basis of depth, liquidity, and continuity of the marketplace * * *.'" [footnote omitted] *House Study* at 138. *See also Hearings Before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 2519*, 93d Cong., 1st Sess. (1973), at 189, 191, 477; *Hearings Before the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 3126*, 93d Cong., 2d Sess., at 171–178 (1974).

Similar statements have been made by other industry representatives, although they have, on other occasions, modified or even retracted their prior pronouncements. *See, e.g., Hearings Before the House of Representatives Committee on Interstate and Foreign Commerce on H.R. 5050 and H.R. 340*, 93d Cong., 1st Sess. (1973), at 997; *Hearings Before the Subcommittee on*

It should be recognized that consideration could be given to whether or not an appropriate fixed rate structure should be constructed as part of a regulatory program of a type commonly employed by governmental entities that regulate utilities.

Such a program, if developed, would appear to have undesirable collateral consequences to the extent it entails a loss of freedom on the part of exchange member firms to exercise their independent judgment in seeking the business of, and furnishing services to, customers of their own choosing. Member firms have not shown any general inclination to support that kind of program, and it must be recognized that such a program would seem to call for elaborate new regulatory structures which might be inconsistent with current public policy views and introduce costs and economic inefficiencies which would have to be carefully balanced against the degree to which the regulatory purposes of the Act could thereby be furthered.[42]

More generally, the *House Study* concluded that, since price fixing is not the norm in a society of free competitive enterprise, "[t]hose who would maintain the fixed minimum commission system bear the burden of proving that it is in the public interest."[43] At the same time, the House Study noted:

Securities of the Senate Committee on Banking, Housing and Urban Affairs on S. 3126, 93d Cong., 2d Sess., at 78 *et seq.*, 155–156, 161 and 178–180 (1974).

[42] In that connection, it should be noted that the exchanges have not made progress in developing a rational methodology which they would be willing to support and which could, in the Commission's judgment, be used to measure the reasonableness of such schedules in the future.

[43] *House Study* at 141. *See also* Securities and Exchange Commission File No. 4–171, Transcript at 45 (1974).

It is often said that while most industries study problems to death, the securities industry studies solutions to death. During the past decade there have been four major studies of the securities industry conducted under the auspices of the SEC. Additionally, the SEC has conducted two major administrative proceedings focusing on the commission rate question and its impact on the structure of the securities industry. These matters have also received the attention of this Subcommittee and the Senate Securities Subcommittee in the current studies of the securities industry. In all, in the past decade there have been at least eight major studies dealing in whole or in part with commission rates and their effect on the industry. The time for study has ended. The time for action has arrived."

Under present circumstances, therefore, it no longer appears necessary or appropriate, in furtherance of any of the purposes of the Act, to permit national securities exchanges to continue to fix the commission rates their members must charge. That conclusion is not retrospective and is, of course, not inconsistent with the fact that such a system in the past may have been justified or may have served valid regulatory purposes. In all events, justifications once adequate may cease to be so and, consequently, a regulatory agency's quasi-legislative action must be predicated on current needs and trends."[45] Similarly, continued monitoring of,

[44] *House Study* at 141. Nevertheless, since the *House Study*, the Commission has held four series of hearings in addition to those to be held in connection with proposed Rule 19b–3 and 10b–22. Securities and Exchange Commission File Nos. 4–167 (1973), 4–171 (1974), 4–172 (1974) and 4–174 (1974).

[45] Since, as noted at p. 34 and n. 46, *infra*, shifting trends can require modification of regulations which previously seemed necessary or appropriate, the regulatory agency in which the Congress has vested the responsibility for administering the

and possible structural changes in, the securities markets over the coming years conceivably could suggest that, under new circumstances and with further experience with the issues, reasonable men might tend toward different conclusions based upon the purposes and standards of the Act."

* * * * *

relevant statutory provisions must exercise a continuing oversight.

Current needs and trends not only are the predicate for requiring that old rules and practices be abandoned; they also require the agency to ensure that new policies are not circumvented. Thus, the Commission has proposed Rule 10b–22 to be adopted if proposed Rule 19b–3 is adopted. At the same time, implementation of a new regulatory environment, even after years of preparation and experimentation, may require some flexibility. On that basis, the administrative process should explore particular ramifications of the new policy carefully and under controlled circumstances, in terms of the relevant statutory principles. Subsection (c) of proposed Rule 10b–22 is an effort to provide an appropriate method by which the Commission can fulfill that important function.

"As the Commission previously has noted, in an analogous context—the adoption of Securities Exchange Act Rule 19b–2:

"The action taken * * * in adopting Rule 19b–2 is not intended to and could not, in light of shifting currents and patterns in the structure of the nation's securities markets, be a definitive resolution of the problems facing the securities industry in this area. * * *

* * * * *

"We have not, in adopting Rule 19b–2, foreclosed the possibility that further changes may, after experience with the rule is gained and after the emerging structure of a central market system is more sharply delineated, be necessary or appropriate. * * * In an area of activity as dynamic and complex as this, there may not be any permanent resolution of industry problems; as conditions change, existing problems may be superseded by new problems, and existing "solutions" may be rendered obsolete. The effective utilization of administrative responsibility and pervasive regulatory oversight de-

As previously indicated, all persons who wish to appear at the oral hearings, which commence on November 19, 1974, should inform George A. Fitzsimmons, Secretary of the Commission, Room 892, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C., 20549, telephone number (202) 755–1160. Persons intending to appear should file with the Secretary 30 copies of the text of any prepared statements not later than 48 hours prior to their appearance and are invited, at the time of their appearance, to make additional copies of their statements available for the benefit of the press and all other interested persons.

Persons wishing to make written submissions of views, data and arguments should file 30 copies thereof with the Secretary not later than December 10, 1974. Copies of all submissions, as well as transcripts of the oral hearings, will be made available in the Public Reference Room, 1100 L Street, N.W., Washington, D.C., and at each regional office of the Commission. Persons wishing to submit written views, data or arguments in respect of submissions made by others or in respect of views, data and arguments presented at the oral hearings may do so until December 24, 1974. All submissions should refer to Securities and Exchange Commission File No. 4–176.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

mands that the agency charged with oversight of an entire industry, such as the Commission, [footnote omitted] remain alert to these changing patterns and problems. We intend to do just that."

Securities Exchange Act Release No. 9950 (Jan. 16, 1973) at pp. 2–3, 38 Fed. Reg. 3902 (Feb. 8, 1973).

Securities and Exchange Commission,

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 11203/January 23, 1975

ADOPTION OF SECURITIES EXCHANGE ACT RULE 19B–3

The Securities and Exchange Commission, acting pursuant to the authority vested in it by the Securities Exchange Act of 1934,[1] and particularly Sections 2, 6, 10, 11, 19 and 23 thereof,[2] has adopted Rule 19b–3. The rule will be effective as to the rates charged by members of national securities exchanges (exchanges) on transactions for persons other than members or associated members (public rates), and for clearance charges,[3] on May 1, 1975, the date originally proposed. As to floor brokerage rates, that is, rates charged to members or associated members except for clearance, the effective date will be May 1, 1976. The rule has otherwise been adopted substantially in the form pro-

[1] 15 U.S.C. 78a *et seq.* (hereinafter cited as the Act).

[2] 15 U.S.C. 78b, 78f, 78j, 78k, 78s and 78w.

[3] In its statement of May 29, 1974, at the *Intra-Member Rate Hearings*, the New York Stock Exchange concluded that fixed rates for clearance could be determined on a competitive basis at the same time as public rates were so determined. Statement of James J. Needham, *In the Matter of Intra-Member Commission Rate Schedules of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–171 (1974), Transcript at 4–5.

posed.[4] The Commission has determined not to adopt proposed Rule 10b–22.

The Commission's determination to defer the effective date of the rule as to floor brokerage rates is based essentially on the following considerations. In the first place, the Commission recognizes that the transition to competitive public rates will create problems of adjustment and accommodation for the exchanges and a deferral of the change as to floor brokerage rates may facilitate the ability of the exchanges to accomplish a smooth transition to the new environment. In addition, it appears that many exchange members did not fully appreciate until September, 1974, following intra-member rate hearings, that the Commission's policy conclusions with respect to fixed commissions, which were announced on September 11, 1973, were applicable to floor brokerage rates and that, consequently, such members may not have had the benefit of the advance notice and time for planning with respect to floor brokerage rates which the September 11th notice was intended to provide. Finally, floor brokerage rates have considerably less impact on public investors than do public rates.[5]

The Commission's decision not to adopt Rule 10b–22 is based, in part, upon a consensus which developed at the *19b–3 Hearings*.[6]

[4] Securities Exchange Act Release No. 11073 (Oct. 24, 1974), 39 Fed. Reg. 38396 (Oct. 31, 1974).

[5] Nothing in Rule 19b–3, however, requires exchanges to wait until May 1, 1976, to eliminate fixed floor brokerage rates, or for that matter, to wait until May 1, 1975, to eliminate fixed public rates.

[6] *In the Matter of Proposal to Adopt Rules 19b–3 and 10b–22 Concerning the Fixing of Commission Rates by National Securities Exchanges*, Securities and Exchange Commission File No. 4–176 (1974).

Rule 19b–3 essentially prohibits any exchange from adopting or retaining any rule that requires, or from otherwise requiring, its members to charge fixed rates of commission for transactions executed on or by the use of the facilities of such exchange after the applicable effective dates. Rule 19b–3 further requires each exchange after the applicable effective dates to provide in its rules that nothing therein shall be construed to require or authorize members to agree or arrange for the charging of fixed rates of commission. The rule would also relieve exchange members and their associated persons of any obligation to comply with rules prohibited by its basic provision, regardless of whether or not the exchange has amended such rules, and such rules could no longer be relied upon. This latter provision, among other things, provides for the contingency that some exchange may not have completed the necessary process of rule amendment by the applicable effective dates of the rule.

Rule 19b–3 is intended to reach all rules governing the fixing of rates of commission on exchange transactions. Thus, for example, in the case of the New York Stock Exchange (NYSE), the provisions of Article XV of the NYSE Constitution relating to floor brokerage could be retained after May 1, 1975; but such provisions may not be retained after May 1, 1976. In addition, other rules, such as NYSE Rules 391, 392 and 393, would have to be amended by exchanges to eliminate provisions intended to preserve the fixed commission rate structure in connection with distributions outside the normal pattern of exchange transactions. It should be noted that Rule 19b–3 covers any "rule of the exchange," which is defined as any provision of the constitution, articles of incorporation, bylaws, or rules or instruments corresponding thereto, whatever the name, of the exchanges.

Introduction

In view of the importance of the issue of commission rates dealt with by the rule and the extensive consideration given to the subject over the past twelve years, not only by the Commission but by Congressional Committees, the Department of Justice, the Treasury Department, exchanges, various firms and organizations in the securities industry, investors and many independent economists, jurists and other scholars, the Commission believes it is appropriate to set forth the reasons for the rule and the relevant considerations in somewhat greater detail than is its usual practice in connection with the adoption of rules or than appears to be required by the Administrative Procedure Act.[7] At the same time, the voluminous materials on this subject which have been developed and considered since 1963 and the numerous questions with respect thereto which have received the Commission's attention make it impossible, if we are to keep this release within any reasonable compass, to do more than highlight those aspects of the matter which the Commission finds particularly significant. It is therefore impractical to undertake a detailed analysis of the large body of underlying facts which entered into the Commission's determination to adopt the rule.[8]

[7] Section 4(c) of the Administrative Procedure Act (5 U.S.C. 553(c)) provides that rules which are adopted shall incorporate "a concise general statement of their basis and purpose." It is our practice to include such a statement in the release announcing the adoption of a rule. This provision may be contrasted with Section 8(c) of that Act (5 U.S.C. 557(c)), which requires, in the case of adjudication, that the decision include a statement of "findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record."

[8] Securities Exchange Act Release No. 11073 of October 24, 1974, in which the Commission released the proposed rule for

More particularly, although the Securities Industry Association raised a question at the *19b–3 Hearings* with respect to the legal authority of the Commission to adopt any rule precluding the exchanges from having rules fixing rates of commission, and similar questions have been raised by others in the past, the Commission does not regard it as appropriate to set forth in this release the legal arguments in support of its authority to adopt the rule. In view of the broad regulatory and rulemaking authority over the securities markets and the securities exchanges, including the specific subject of commission rates, granted to the Commission by the Act, the Commission, after careful consideration of the legal issues, is satisfied that it has authority to adopt Rule 19b–3, if it makes, as it has done, the basic findings called for by the Act.

The Act was passed against the background of the stock market crash of 1929 and in the light of the extensive study and investigation by the Senate Committee on Banking and Commerce entitled "Stock Market Practices." It was consequently a basic, if not the basic, purpose of this legislation to provide for regulation of the stock market and of transactions and practices relating thereto. It was intended that this regulation be comprehensive and complete. Indeed, the Congress so stated in the preamble of the Act which stated that it is "necessary to provide for regulation and control . . . and to impose requirements necessary to make such regulation and control reasonably complete and effective." This objective was approached in a variety of ways. The Commission was established to administer the Act; and exchanges are

public comment, contained a list of some of the more important source materials relating to this subject, which mere list covered two and one-half printed pages. Reference thereto is hereby made.

required to register with the Commission, are charged with the duty of self-regulation of their members and may become registered only if the Commission concludes, among other things, "that the rules of the exchange are just and adequate to insure fair dealing and to protect investors." In addition to statutory provisions regulating various trading practices and activities of members, Section 19(b) of the Act supplements the initial authority of the Commission over exchange rules by authorizing it to alter or supplement the rules of an exchange with respect to various significant matters, including "the fixing of reasonable rates of commission, interest, listing and other charges." The standard for such action is that such alterations be "necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange." As the House Committee put it, this authority was intended to permit the Commission to effect changes in exchange rules "in any important matter . . . appropriate for the protection of investors or appropriate to insure fair dealing." [9]

In view of the complexity of the subject and of changing conditions, great reliance was placed upon broad rulemaking power so as to enable the Commission to respond flexibly to changing regulatory needs. In light of these considerations, the Commission believes that the express authority granted to it over the subject of commissions which, as the *Special Study* [10]

[9] *Report of House Committee on Interstate and Foreign Commerce on H.R. 9323*, H.R. Rep. No. 1383, 73d Cong., 2d Sess. 15 (1934).

[10] Securities and Exchange Commission, *Report of Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963).

said, are "the lifeblood of the brokerage business today even as in 1972," [11] encompasses the authority to accomplish necessary changes in those rules.

An extensive discussion of the history and interpretation of the Commission's rulemaking authority under the Act is found in Securities Exchange Act Release No. 9950 (Jan. 16, 1973), 38 Fed. Reg. 3902 (Feb. 8, 1973), to which reference is hereby made.

The remainder of this release consists of the following sections:

1. Summary of the Evolution of Exchange Commission Rates and of the Commission's Consideration of Them.
2. Reasons for the Rule.
3. Comments on the Rule.
4. Conclusion.
5. Text of the Rule.

1. Summary of the evolution of exchange commission rates and of the Commission's consideration of them

The practice of fixing commission rates on stock exchanges in the United States is generally traced back to the so-called Buttonwood Tree Agreement of 1792, which provided:

> We, the Subscribers, Brokers for the Purchase and Sale of Public Stock, do hereby solemnly promise and pledge ourselves to each other, that we will not buy or sell from this day for any person whatsoever, any kind of Public Stock at a less rate than one-quarter percent Commission on the Specie value, and that we will give a preference to each other in our Negotiations. In Testimony whereof we have set our hands this 17th day of May, at New York, 1792.[12]

[11] 2 *Special Study* 295.

[12] Eames, *The New York Stock Exchange* 14 (1894).

Although present exchange commission rate rules have become far more complex than this simple paragraph, the essentials are the same. The members undertake not to deal at a rate less than the fixed commission, that is, the public rate, and to give preference to each other, that is, the intra-member rates. The ancient lineage of exchange rate fixing, and the fact that it has persisted for over a century and a half without serious challenge, naturally provoke inquiry as to why it should be questioned now. The answer is that exchange commission rate fixing operates now in a far different environment than it did in earlier periods. During the period from 1792 to approximately the end of World War I, exchange commission rates were of little public importance. The general public was not involved to any significant extent in exchange trading in equity securities and there was some justification for regarding the stock exchanges as, in considerable measure, private clubs. While certain aspects of exchange operations gave rise to increasing public concern in the late years of the 19th Century and the opening years of the 20th Century, commission rates were not among them.

After the end of World War I, the public participated increasingly in exchange trading in equity securities and the stock market assumed unprecedented importance in the functioning of the economy. The disastrous events of 1929 demonstrated that the exchanges had not satisfactorily adapted to their new status as institutions with far reaching public reponsibilities and led to the comprehensive Congressional investigations of the early 1930's. The evils and malpractices thus uncovered, in turn, gave rise to the movement for reform which culminated in the enactment of the Act in 1934 with its comprehensive scheme of governmental regulation. But attention was then

focused primarily upon such obvious evils as corners, pools, manipulations, insider trading, and other fraudulent and deceptive practices which seriously injured investors. With respect to commission rates, there was some concern with the possible overcharging of unsophisticated investors, and with posible monopoly profits, and the Commission was given regulatory authority.

Between World War II and the early 1970's, the public flocked into the securities markets, and financial institutions increasingly participated in those markets. As a result of Congressional concern as to the adequacy of investor protection under these circumstances, two major studies were made under the auspices of the Commission. The first of these was the monumental *Special Study*, made essentially during the period from the end of 1961 to the middle of 1963, pursuant to Congressional direction embodied in an amendment to the Act. The second of these studies was the *Institutional Investor Study*,[13] made essentially in 1969 and 1970, pursuant to another amendment to the Act. The *Special Study* noted that during the 1952–1961 decade, the number of individual shareholders in America grew almost three times but that, despite this expansion, activity of individuals as a proportion of total NYSE share volume decreased from 57% in 1952 to 51.4% in 1961; during the same period, the *Special Study* observed, institutional activity rose from 24.6% in 1952 and 19% in 1953 to 26.2% of such volume in 1961.[14] The *Institutional Investor Study* noted a further decrease in the volume accounted for by the public to 33.4% at the end of 1969 and an increase in the institutional share during

[13] Securities and Exchange Commission, *Institutional Investor Study Report*, H.R. Doc. No. 92–64, 92d Cong., 1st Sess. (1971).

[14] 2 *Special Study* 6.

the same period to 42.4%.[15] The institutional share has continued to rise at least through 1971, the latest year for which the NYSE has made available a public transaction study.[16]

The *Special Study* included probably the first reasonably comprehensive analysis of the nature and structure of commission rates and their impact, together with the procedures and standards involved in setting and reviewing such rates. The *Special Study* did not, however, consider the question of fixed vs. competitive commissions. Nor did it believe that it was either "called upon or equipped" to study the level of commission rates or to express any view with respect to their reasonableness. Nevertheless, the *Special Study* did point out certain problems presented by the commission rate structure, some of which are still unresolved. These include the fact that the commission rate schedule covers a great variety of services performed by brokers in addition to the execution and clearance of transactions. That characteristic of the rate schedule has induced service competition rather than price competition and has resulted in complex and irrational distinctions between permissible ancillary services and prohibited rebates of the minimum commission. The *Special Study* also noted the prevalence of reciprocal arrangements and pointed out that the nature of the securities commission business is such that traditional principles of rate regulation can hardly be applied to it. In that connection, the *Special Study* said:

> It is important to reemphasize that, while the security commission business shares, with other businesses subject to rate regulation, the qualities of being "affected with the public interest"

[15] *Institutional Investor Study*, Supp. Vol. 1 at 147.

[16] *NYSE 1974 Fact Book* 55.

> and of being limited to a standard of "reasonable" rates, the differences are perhaps more significant than the similarities, and the problem here is in many ways unique. Thus, the public utility normally possesses a franchise conferring upon it monopoly rights to furnish a service required by the public and also obligating it to furnish service to all who need it at reasonable prices. In contrast, though the auction market of the NYSE is a dominant unit in the structure of our capital markets, about 500 member firms compete with each other for the business of the public to be transacted on the NYSE within the confines of the same commission rate schedule. Moreover, they compete with other investment media for the public's savings, and the Exchange itself competes as a marketplace with other markets, both for the listing of issues to be traded and for transactions in listed issues also traded on other exchanges (dually traded securities) or in the over-the-counter market.
>
> There are other important economic differences. Public utilities generally are characterized by relatively high investment in fixed plant and equipment, while the security commission business is essentially a service business requiring relatively small capital investment but relatively high personnel costs. The income of utilities tends to be more stable than that of industry generally while that of the security commission business fluctuates much more widely. These differences make it clear that the problem of "reasonable" rate level can be solved by no simple transfer of principles evolved in the field of utility regulation to the security commission business.[17]

It was further pointed out that a basic dilemma was involved in the setting of commission rates. Tradition-

[17] 2 *Special Study* 328–329 (footnote omitted).

ally, the rates have been set, at least in part, in terms of a commission per share. This means that with a per share commission the commission charge on a given number of shares of a low priced stock is a far larger proportion of the amount invested than the commission on the same number of shares of a high priced stock. On the other hand, a commission schedule based on the dollar amount of the investment would produce a far higher commission on a given number of shares of a high priced stock than on a given number of shares of a low priced stock although the cost of executing the two orders would normally not be very different. In the context of a fixed rate structure, no satisfactory solution to this dilemma was yet been found.

The *Special Study* also pointed out that five commission rate increases occurred between the enactment of the Act and 1963, and that in connection with each reference was made to generalized concepts of cost and profit but that the available data for the determination of these was entirely inadequate and that complex problems of allocation of costs existed as well as the even more difficult conceptual problem of giving content to the general standard of reasonableness in an industry to which traditional ratemaking concepts were largely inapplicable.

Over the years since the *Special Study*, strenuous efforts were made by the Commission and the exchanges to deal with the problems and to correct the defects pointed out. Thus, volume discounts were introduced, customer directed give-ups were abolished, income and expense data for member firms were substantially improved and efforts were made to develop principles for the allocation of costs and also to develop a ratemaking philosophy. It is fair to state, however, that the latter efforts have not been successful. The NYSE has acknowledged that it has not established a basis for allocating costs between the stock exchange commission business and other business done by member firms and has requested the Commission to pass upon recent proposals for rate increases upon the basis of the overall profitability of the securities industry and the impact of inflation upon various costs incurred by member firms. The exchanges and representatives of the brokerage industry acknowledged at the *19b–3 Hearings* that they had not yet endeavored to develop and present a philosophy or a set of principles to be applied in ratemaking.

The Commission has held two major hearings with respect to rate structure since the *Special Study*. The first of these was the *Rate Structure Hearings*[19] commenced in early 1968. In those hearings, the question was, for the first time, directly raised as to whether rate fixing by exchanges should be replaced by competition. The Antitrust Division of the Department of Justice participated in those hearings in order to "raise questions concerning the relationship between * * * the Exchange Act and the public policy embraced in the Federal antitrust laws."[20] In the

[19] *In the Matter of the Commission Rate Structure of Registered National Securities Exchanges*, Securities and Exchange Commission File No. 4–144 (1968–1971).

[20] It is rather surprising that, although the exchanges have been engaged in a combination to fix commission prices both before and ever since the Sherman Act was passed in 1890, the first direct antitrust challenge to stock exchange rate fixing in the federal courts did not come until the *Kaplan* case in 1966. *Kaplan* v. *Lehman Bros.*, 371 F. 2d 409 (7th Cir.), *cert. denied*, 389 U.S. 934 (1967). Perhaps this was, at first, attributable to the early idea that the commerce clause of the Constitution and the Sherman Act applied only to transactions in "commodities." *See Hopkins* v. *United States*, 171 U.S. 578, 597–98 (1898);

course of the hearings, the NYSE stated that it would retain economic consultants to develop a cost-based commission rate schedule. The Commission agreed to await completion of that study before resolving the basic question but, nevertheless, invited written submissions and oral presentations in preparation for the resolution of those issues. In response to the Commission's invitation, the Antitrust Division of the Department of Justice stated, in effect, that the Commission should develop a transitional program which would permit it to institute competitive commissions gradually, commencing with larger volume transactions.[20]

The NYSE study was thereafter accelerated and in February, 1970, the NYSE presented to the Commission a study entitled "Reasonable Public Rates for Brokerage Commissions—A Report by National Economic Research Associates, Inc. to the Cost and Revenue Committee of the New York Stock Exchange."[21] The NYSE subsequently made clear, however, that its Board of Governors had not approved the proposed commission rate schedule set forth in the *February*

United States v. *South-Eastern Underwriters Ass'n*, 322 U.S. 533 (1944); *Atlantic Cleaners & Dyers* v. *United States*, 286 U.S. 427 (1932). Since 1934, federal regulation under the Act has affected the application of the antitrust laws to stock exchange actions. *See Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963). The status of stock exchange rules fixing commissions under the antitrust laws in view of the provisions of the Act is expected to be clarified by the Supreme Court in the near future unless mooted by enactment of legislation now pending in the 94th Congress. *See Gordon* v. *New York Stock Exchange*, 498 F. 2d 1303 (2d Cir.), *cert. granted*, 95 Sup. Ct. 491 (1974).

[20] *Rate Structure Hearings*. Memorandum of the Department of Justice on the Fixed Minimum Commission Rate Structure, Jan. 17, 1969, at 194–195.

[21] Hereinafter cited as the *February NERA Report*.

NERA Report and that the *February NERA Report* was merely a study presented for discussion.[22]

The Commission reconvened hearings to analyze a new commission rate schedule proposed in June, 1970, by the NYSE. The NYSE proposal departed from a cost-based schedule, such as that set forth in the *February NERA Report*, by limiting increases on small orders and decreases on large orders called for in the original study.[23]

In October, 1970, the Commission concluded that the data submitted in support of the NYSE proposal did not provide a complete answer to the problems of commission rate structure, but that it would not be in the public interest to leave the subject indefinitely in abeyance. Accordingly, while the Commission stated that it would not raise any objection if the proposed schedule were adopted with specified modifications and upon the understanding that specified steps would be taken to provide a better basis for the determination of commission rates, it also stated that it was of the

[22] NYSE Special Membership Bulletin, Feb. 12, 1970; NYSE Special Membership Bulletin, Feb. 19, 1970.

[23] The NYSE submitted in support of its proposal a revised study entitled "Stock Brokerage Commissions, the Development and Application of Standards of Reasonableness for Public Rates, a Report by National Economic Research Associates, Inc. to the Cost and Revenue Committee of the New York Stock Exchange" (July 1970) (hereinafter cited as the *July NERA Report*). The *February NERA Report* had proposed a 116.3 percent increase in the commission on an order involving 100 shares of stock selling at $10 per share; the NYSE proposal called for a 50 percent commission rate increase. For an order of 1,000 shares of a stock selling at $50 per share, the *February NERA Report* had proposed a 36.3 percent commission rate reduction; the NYSE proposal called for a 10 percent commission increase. For further comparisons, see Table XI-4 of the *February NERA Report* and Table XII-3 of the *July NERA Report*.

opinion that fixed charges for portions of orders in excess of $100,000 were neither necessary nor appropriate. It further requested that a plan for reasonable economic access for non-member broker-dealers be presented.[24]

In March, 1971, the *Institutional Investor Study* was transmitted to the Congress. That *Study* was basically an economic study conducted primarily by economists and it included an examination of the impact of institutional investment upon the securities markets. This aspect of the *Institutional Investor Study* is relevant to the question of commission rates since one of the principal problems with the commission rates was the generally unsuccessful effort to

[24] Securities Exchange Act Release No. 9007 (Oct. 22, 1970). In the course of the *19b–3 Hearings*, reference was made to that release as making the continuation of minimum commissions dependent on the adoption of a uniform system of accounts. While indicating that implementation of a uniform system of accounts, as well as uniform and adequate methods of cost allocation, was necessary to the continuance of a system of fixed rates for exchange transactions, that release also stated that fixed charges for portions of orders in excess of $100,000 were neither necessary nor appropriate. The inadequacies of the data submitted in support of the NYSE proposal were subsequently pointed out to the NYSE. *See* letter dated April 23, 1971, from Irving M. Pollack, Director, Division of Trading and Markets, to William C. Freund, NYSE Vice President and Economist. As indicated *supra*, p. 11, exchanges have not established a basis for allocating costs between stock exchange commissions and other business done by member firms. Furthermore, by the end of 1970 it appeared that the banning in 1968 of customer directed give-ups and the simultaneous introduction of the volume discount had not solved the regulatory problems of fixed commission rate schedules. *See* Address by Robert W. Haack before the Economic Club of New York, Nov. 17, 1970, quoted in *The New York Times*, Nov. 18, 1970, at 76, col. 8. *See also* 4 *Institutional Investor Study Report* 2206.

adapt them to the needs of both individual investors and large institutional investors. Upon the basis of the data and analysis of the *Institutional Investor Study* with respect to this matter, the Commission concluded, as stated in its letter of March 10, 1971, to the Congress in transmitting the *Study:*

> It is clear that the securities markets are changing in rapid and significant ways. There are a number of reasons for these changes; among the most important are the greatly increased volume of trading by institutions, the negotiated nature of many institutional transactions, the fixed minimum commission rates that stock exchanges impose on such transactions and technological advances in communications and data processing. The evolution of the securities markets has been, and may continue to be, affected and distorted by barriers to competition. Among the most significant of these are minimum commission rates and rules that insulate markets, market makers and broker-dealers from each other. The combination of fixed minimum commission rates and barriers to access have tended to cause institutions to choose market places, in part at least, for the purpose of reducing the commission they pay or taking advantage of opportunities to purchase various services with "soft" commission dollars by means of reciprocal practices. These appear to be the most important explanations for the accelerating growth of institutional trading on the regional stock exchanges and in the third market. Because the assembly of many block trades takes place primarily over the upstairs communications systems of broker-dealers rather than on the floor of any stock exchange, such transactions can be executed wherever the participants select, and markets have therefore been selected on the basis of these considerations.

> The fixed minimum stock exchange commission on large orders had led to the growth of complex reciprocal relationships between, on the one hand, institutions (particularly mutual fund managers and banks) and, on the other, broker-dealers. This has had the effect of making commission rates for institutions negotiable but limiting the extent to which the ultimate investor rather than the money manager has benefited from such negotiation. As noted earlier, these relationships tend to aggravate potential conflicts of interests, to be anti-competitive in nature and to impede the development of a central market system for securities trading. Elimination of fixed commission rates for institutional size transactions should go some distance toward dealing with these problems. The Commission will closely observe the extent to which competitive commission rates lead toward these results.[26]

In April, 1971, at the direction of the Commission, exchanges provided that commissions on the portion of exchange orders involving $500,000 or more were to be competitively determined. In July, 1971, the Commission reconvened its commission rate hearings to receive testimony and other relevant data concerning a proposed rate structure based in part on the methodology developed in the preceding year by the economic consultants engaged by the NYSE. The following September, the Commission advised the NYSE that it would not raise any objection to the new rate schedule if certain additional modifications to then prevailing commission-related practices were effected (including implementation of economic access for non-member brokers permitting discounts of up to 40 percent from the public rate).[26]

[25] *Institutional Investor Study*, Summary Vol. xxii. *See infra* n. 13.

[26] Securities Exchange Act Release No. 9351 (Sept. 24, 1971).

In not objecting to the NYSE's rate proposal the prior October, the Commission had specifically requested the presentation not alter than May 31, 1971, of a uniform accounting system in order to evaluate the need for a fixed commission rate system.[27] In September, 1971, the Commission recognized that the inability of the NYSE appropriately to allocate costs and revenues between brokerage and other activities engaged in by members had necessitated consideration of the proposal on the basis of the total financial experience of member firms. The Commission, therefore, extended until May 1, 1972, the period for submission of uniform reporting by member firms in order to permit evaluation of subsequent commission rate proposals.[28]

Beginning in October, 1971, the Commission held the *Hearings on Market Structure*[29] and, on February 2, 1972, issued the *Market Structure Statement*,[30] which was based on those hearings as well as the earlier studies and hearings extending back over a decade.[31] The *Market Structure Statement* concluded

[27] *See* n. 24 *supra*.

[28] The Commission also indicated that it was continuing to study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000. *See* Securities Exchange Act Release No. 9148 (Apr. 14, 1971).

[29] *In the Matter of the Structure, Operation and Regulation of the Securities Markets*, Securities and Exchange Commission File No. 4–147 (1972).

[30] Securities and Exchange Commission, *Statement on the Future Structure of the Securities Markets*, 37 Fed. Reg. 5286 (Mar. 14, 1972).

[31] The *Market Structure Statement* expressed the unanimous view of the Commission as it was then constituted (Chairman Casey and Commissioners Owens, Needham, Herlong and

that a reduction to $300,000 was called for in the breakpoint above which commission rates on exchange transactions should be competitively determined. In reaching that conclusion, however, the *Market Structure Statement* noted that the securities industry had operated under fixed commission rates for a very long time and that it would, therefore, be appropriate to measure the effect of competitive commissions carefully, on a step-by-step basis. The Commission recognized the possible risk of a precipitate movement toward moving toward competitive rates, but concluded that that did not rule out moving toward competitive rates, at least on large orders, at a measured, deliberate pace and that the Commission rate structure would ultimately be based upon the cost characteristics of the service being offered.[32] In response to the Commission's conclusions, the breakpoint on fixed commission rate schedules was lowered to $300,000 in April, 1972.

In May, 1973, the NYSE proposed to increase commission rates; the Commission received comments on that proposal at a public hearing and, in September, 1973, determined not to raise any objection to the proposed inereases or to their continuation through March 31, 1974.[33] The Commission also indicated that

Loomis), although Commissioner Owens took a different view with respect to restrictions on transactions by institutionally affiliated brokerage firms for their institutional affiliates.

[32] *Market Structure Statement* 16. The emphasis of the *Market Structure Statement* was on fostering free and open competition, not only with respect to commission rates but also competing market makers.

[33] On September 3, 1974, the NYSE proposed to increase rates again. As subsequently modified, the NYSE's proposal called for an increase of 8 percent on minimum rates of commission on transactions involving from $5,000 to $300,000. After receiving information with respect to the NYSE's

it would act promptly to terminate the fixing of commission rates after April 30, 1975, if the exchanges did not, on their own initiative, adopt rule changes achieving that result.[34]

Subsequently, the NYSE proposed to provide for competitively determined commission rates on transactions involving less than $2,000. That proposal, as resubmitted in amended form by the NYSE to exclude intra-member rates (that is, rates paid by members to other members for floor brokerage and clearance), was adopted by the NYSE and other exchanges and became effective on April 1, 1974. In withdrawing its initial proposal, NYSE Board of Directors stated that it did not believe it was necessary to amend the intra-member rate schedules as originally proposed in order to provide experimentation with competitive commission rates.[35] The Commission then held the *Intra-Member Rate Hearings,* at which the NYSE announced its willingness to abandon fixed intra-member commission rates for clearance.[36]

proposal and holding a public hearing, the Commission determined not to invoke its jurisdiction to object to the NYSE's proposal. *See* Securities Exchange Act Release No. 11089 (Nov. 6, 1974), 39 Fed. Reg. 43250 (Dec. 11, 1974).

[34] Securities Exchange Act Release No. 10383 (Sept. 11, 1973), 38 Fed. Reg. 27243 (Oct. 1, 1973). The NYSE Board of Directors had already adopted on the preceding March 1 a resolution calling for a combined program of legislation and regulation concurrently eliminating fixed commission rates on all orders and establishing the requirement that all trades of listed securities be made on national securities exchanges operating under similar rules and regulations.

[35] Securities Exchange Act Release No. 10669 (Mar. 6, 1974).

[36] In Securities Exchange Act Release No. 11019 (Sept. 18, 1974), 39 Fed. Reg. 35214 (Sept. 30, 1974), the Commission indicated that it had not been persuaded, on the basis of the data and views obtained at the public hearings on intra-member rates and otherwise, that its policy conclusions of September 11, 1973, should not also be applicable to intra-member rates.

During the same period the Committees of the Congress having jurisdiction over securities regulation had also turned their attention to the issue of fixed vs. competitive rates. Both the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs and the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives initiated in 1971 a comprehensive examination of the securities industry. These studies were primarily occasioned by the operational and financial crisis in the securities industry in 1969 and 1970 which had led the Congress to enact the Securities Investor Protection Act of 1970.[37] That Act, in effect, provided government insurance for investors against loss resulting from the insolvency of broker-dealers and created a potential liability of the Treasury to cover such claims. The Committees felt that they should independently study the industry to examine the conditions which made such legislation necessary. Both Committees carefully studied the problems arising from fixed commissions. The recommendations of the Senate Subcommittee contained in its Report of February 4, 1972, with respect to commission rates were as follows:

> The related questions of stock exchange commission rates and exchange membership for institutions have been the subject of intensive hearings before the SEC for 3½ years. A review of the record of these proceedings and of the statements submitted to the Subcommittee itself on these questions reveals clearly that the

[37] 15 U.S.C. 78aaa *et seq.* The Securities Investor Protection Corporation established by that Act is required to provide for the satisfaction of claims against a bankrupt broker, not exceeding $50,000 for each customer (subject to a limitation of $20,000 for claims for cash).

> present distortions and fragmentation of our securities markets cannot be effectively dealt with so long as the NYSE and other stock exchanges are permitted to fix the commissions that their members must charge, at least on large transactions. The industry expects, and is entitled to, a clear statement of government policy as to when and how the present restrictions will be removed. This requires the setting of a date certain for elimination of fixed rates on institutional-size transactions, which have resulted in the most serious distortions. This could best be achieved by eliminating fixed rates on orders in excess of $100,000. In addition, to provide the possibility of lower rates to small investors, brokerage firms, after appropriate filings with the SEC, should be permitted to charge lower fees for "unbundled" services than are required by the current fixed rate schedules for the full range of brokerage services.[38]

The House Committee in its recommendations went somewhat further, stating that:

> The Subcommittee finds that fixed minimum commission rates are not in the public interest. We have reviewed our own record, the relevant portions of the SEC's record and that of the Senate study. On the basis of that review the Subcommittee finds that the fixed minimum commission rate system should be replaced by one where commission rates are determined by the forces of competition. We find further that competitively determined rates should apply to all transactions regardless of size, and that a competitive commission rate system should be phased in without excessive delay.

[38] *Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the Senate Committee on Banking, Housing and Urban Affairs (For the Period Ended Feb. 4, 1972)*, 92d Cong., 2d Sess. (1972).

The SEC has indicated that it will seek reduction of the level from $300,000 to $200,000 by April of 1973 and then to $100,000 by April of 1974. The New York Stock Exchange has proposed a slightly different timetable, and stated that it will review the level for competitively determined commission rates in October 1972.

The Subcommittee has heard testimony that the difference in impact on the industry between a $500,000 breakpoint and a $300,000 breakpoint is minimal, and a number of witnesses indicated that a further reduction in the breakpoint may be warranted prior to the date scheduled by the SEC. The Subcommittee agrees. A further reduction in the breakpoint by the Exchange when it conducts its review in October is warranted. The SEC could then adjust its timetable accordingly. So long as reasonable progress along this road is being made, the Subcommittee will defer legislative action.

The Subcommittee agrees with the testimony of a large number of witnesses that there is no reason to freeze competitive rates at the $100,000 level. The Subcommittee finds no logical justification for competition on institutional size transactions while perpetuating rate fixing on transactions of small investors. If steps are not taken to continue to reduce the breakpoint below the $100,000 level until all fixed rates are abolished, the Subcommittee will introduce legislation to do so.

There has been much debate over the desirability of a fixed minimum commission rate system. But the Congress, the Department of Justice, and the SEC have determined that the public interest will best be served by replacing fixed prices with a competitive rate system. The debate should now end. If the securities industry expends as much energy in adjusting to a competitive system as it has in debating its

wisdom, the Subcommittee is convinced that the industry will not only survive, but it will flourish.[39]

Following the completion of these *Studies,* legislation to implement the recommendations of the respective Committees was introduced in the Senate and in the House. The Senate bill passed the Senate but the House bill, although favorably reported by the Committee on Interstate and Foreign Commerce, was not acted upon in the 93d Congress. Similar legislation has been introduced in both Houses in the 94th Congress.[40]

2. Reasons for the rule

The basic reason for the Commission's decision to adopt Rule 19b–3 was the conclusion that, under present circumstances, the free play of competition can provide a level and structure of commission rates which will better serve the interests of the investing public, the securities markets, the securities industry, the national economy and the public interest than any system of price fixing which can reasonably be devised. Furthermore, the Commission concludes that there is no economic requirement for fixed rates of commission in the securities industry, as is evident from the practical experience of the over-the-counter market, where no such structure exists, as well as all of the data which has been accumulated concerning the nature and characteristics of the securities commission business.[41] Consequently, even if it were possible to

[39] *Securities Industry Study, Report of the Subcommittee on Commerce and Finance of the House Committee on Interstate and Foreign Commerce,* H.R. Doc. No. 92–1519, 92d Cong., 2d Sess. (1972).

[40] H.R. 10 and S. 249, 94th Cong. 1st Sess. (1975).

[41] The securities commission business, of course, is not a natural monopoly or utility which requires fixed rates because price

devise a better scheme of fixed rates, the commitment of resources would not appear to be justified under present and foreseeable conditions in view of the strong probability that no such system would work as well as competition. The foregoing conclusions are consistent with the American tradition of reliance upon free competition to determine prices and allocate resources, as reflected by the public policy embodied in the antitrust laws. It should be emphasized, however, that the Commission's conclusions are not based upon any simplistic notion that competition is a "good thing" in all lines of endeavor, including a regulated industry, and that, therefore, competitive rates should be substituted regardless of experience and circumstances. Rather, this conclusion is based upon the entire experience of the Commission and the securities industry with fixed rates, particularly during the last decade and more, and the intensive studies which have been made of that subject by so many competent persons.

The existing commission rate structure has demonstrably worked badly during that period. It has led to distortions, evasions, conflicts of interest,[42] and

competition is impossible. It is, however, contended that the securities commission business is of so vulnerable a nature that it cannot survive price competition or, stated otherwise, that it is subject to "destructive competition." Certain reasons for rejecting that conclusion are discussed under the next heading in this release.

[42] The fixed rate structure tends to create conflicts of interest on the part of institutional investors who are usually engaged in managing investments on behalf of others, rather than investing their own money. In these cases, the institutional manager allocates the commission business among brokers but the beneficiaries, in effect, pay the commissions. Since brokers provide a great variety of services which are compensated by commissions, institutional managers are constantly tempted to direct

inefficiencies, and has obstructed at every step the ability of the securities markets to adapt themselves to the demands of our time. It has impeded the evolution of a central market system and has fragmented the markets, impairing their ability to concentrate the flow of orders and to mobilize marketmaking resources necessary to provide depth and liquidity in a market increasingly affected by institutional participation.

It has also, by its rigidity and delay, inhibited innovations in the rendering of brokerage services to the investing public and in the ability of the securities industry to adjust rapidly to the rapid fluctuations in the volume of trading and, therefore, in the demand for brokerage services. Some of these difficulties seem to be inherent in a fixed rate system as applied to a dynamic and rapidly changing industry.

When the Commission commenced its inquiry into the commission rate structures at the time of the

the brokerage business of their beneficiaries to brokers who will provide services for the benefit of the manager. The problem is aggravated by the fact that under prevailing accounting practices and tax law, commissions are treated as part of the purchase price of securities bought, or as a deduction from the proceeds of securities sold, rather than being accounted for as expenses incurred in the management of the portfolio. Under these circumstances, investment managers may be inclined to seek services in exchange for brokerage since the cost of such services may be buried in the carrying value of the portfolio securities rather than charged to the beneficiaries as an expense of administration. The tendency of this situation to corrupt fiduciary relationships is not the least of the evils resulting from the present commission rate system. Even where no misconduct is present, the situation leads to inefficiency in the management of assets. The foregoing does not mean that fiduciaries may not utilize commissions on transactions for beneficiaries to obtain for their beneficiaries research and other valuable services. Certain aspects of this matter are discussed below in connection with the so-called "fiduciary question" raised by certain persons in connection with the proposed rule.

Special Study, fixed commission rates were assumed by everyone, including the Commission, to be a normal and necessary feature of the exchange markets. It became more and more clear in the light of later experience that this was not the case. However, the virtues of the traditional system were staunchly defended throughout the Commission's hearings in 1968 and 1969 and in the hearings before Congressional Committees in 1971 and 1972. In contrast, at the *19b–3 Hearings,* the existing system had few defenders. Those who opposed the proposed rule largely confined themselves to either asking for delay, or suggesting that the initiation of competitive commission rates should await a more prosperous period, or be deferred pending the taking of certain further steps toward a central market system, or the adoption of certain proposed safeguards for the auction market process.[43] A few witnesses suggested that some vaguely outlined better system of fixed commission rates should be developed. No one supported any extended continuation of the status quo at least with respect to public rates.

The foregoing does not reflect any judgment by the Commission that the fixed minimum commission rate always was bad or that it was, or now is, illegal, or that fixed commissions could never be appropriate in the future. Rather, it simply reflects a conclusion, based upon the Commission's experience and the abundant data alluded to earlier that, under the conditions now existing, fixed minimum commissions should terminate at the times specified in the rule. It is not possible to predict future developments or future conditions and it is conceivable that unforeseen developments could require the Commission to reinstitute some form of fixed rates, although the Commission does not anticipate or believe that this will become necessary.

[43] *See infra* "Comments on the Rule."

3. Comments on the rule

In addition to a number of comments urging prompt adoption of Proposed Rule 19b–3,[44] a number of comments were recived either opposing its adoption or suggesting changes in timing to allow for other developments or to await improved economic conditions, or urging that other action be taken by the Commission in conjunction with its adoption. The princi-

[44] *See, e.g.*, statements at *19b–3 Hearings* by Representative William S. Stuckey, Jr., United States House of Representatives; James H. Lorie, Professor of Business Administration, University of Chicago; Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University; Marshall E. Blume, Professor of Finance, University of Pennsylvania; Donald Farrar, Professor of Finance, University of California, Los Angeles; Walter Werner, Professor of Law, Columbia University; Richard West, Dean, University of Oregon; David L. Ratner, Professor of Law, Cornell University; Robert Loeffler, Trustee, Equity Funding Corporation of America; James B. Halpern, of Arent, Fox, Kintner, Plotkin and Kahn; Philip G. Conner, Executive Vice President of Conner, Redwine, Inc.; Mark M. Batatian, President, Prudential-American Securities, Inc.; Charles T. Bauer, Chairman, Committee of Investment Officers, American Insurance Association. Comments of the United States Department of Justice, Dec. 10, 1974.

In addition, a number of letters supporting prompt adoption of the rule were received subsequent to the *19b–3 Hearings. See, e.g.*, letters from Senator Harrison A. Williams, Jr., Chairman of the Senate Subcommittee on Securities (Dec. 16, 1974); Senator Philip A. Hart, Chairman of the Senate Subcommittee on Anti-trust and Monopoly (Dec. 17, 1974); Representative John E. Moss, Chairman of the House Subcommittee on Commerce and Finance (Dec. 16, 1974); Representative Peter W. Rodino, Jr., Chairman of the House Subcommittee on Monopolies and Commercial law (Dec. 18, 1974); and William R. Salomon, Salomon Brothers.

pal arguments for permitting fixed minimum commission rates to continue were the contentions that the brokerage industry is subject to "destructive competition," that the fixed commission rate structure provides desirable subsidies which cause the securities markets to operate more efficiently and fairly and that the existence of a fixed commission rate, by encouraging membership on exchanges, is desirable to promote self-regulation.

The proposition that the brokerage industry, if subjected to competitive commission rates, would be susceptible to destructive competition was first elaborated in 1968; and it was again urged, in opposition to Rule 19b–3. The economic prerequisites for the type of destructive competition postulated are, however, the existence of fixed costs constituting a high percentage of total costs, and the availability of economies of scale applicable to a substantial percentage of an industry's aggregate production. Under those circumstances, it is argued that price competition, during periods of low demand and excess capacity, may be expected to drive prices down to marginal costs, which would be below average costs, resulting in losses for a large part of the industry. Eventually such conditions would result in a contraction of industry capacity to a level below that which is necessary to supply the public need and an undue degree of concentration in the brokerage industry which would have adverse effects on the functioning of the securities markets.

The possibility of destructive competition in the brokerage industry has been, since 1968, subject to careful analysis by a number of independent economists.[45] These analyses demonstrate that the brokerage

[45] *See, e.g.*, Baxter, *NYSE Fixed Commission Rates: A Private Cartel Goes Public*, 22 Stanford L. Rev. 675 (1970);

industry's fixed costs are not high in relation to its total costs even though fixed costs have sharply increased since 1968 and that there are no economies of scale which should lead to undue concentration with competitive commission rates. It has also been pointed out that, above a critical level necessary to provide modern electronic facilities by contract or otherwise, other forms of competition such as service competition could be expected eventually to have effects similar to those of price competition so that a fixed commission rate system, absent controls on the type and quantity of services, does not assure that there will not be increasing concentration in the brokerage industry.[46] Experience with competitive commission rates on large transactions since April, 1971, and on small transactions since April, 1974, has tended to bear out the analysis that the brokerage industry is not subject to destructive competition as postulated.

Coupled with the destructive competition argument has been an acknowledgment that any now fixed commissions would have to be based on costs with suggestions that the Commission develop the necessary analysis. To date the exchanges have not devised a system for allocating costs between stock exchange commission business and other business not involving fixed rates; furthermore, they have been reluctant to adopt schedules recommended on the basis of available cost

Friend and Blume, *Competitive Commissions on the New York Stock Exchange*, 28 The Journal of Finance 795 (1973); Mann, "A Critique of the New York Stock Exchange's Report on the Economic Effects of Negotiated Commission Rates on the Brokerage Industry, the Market for Corporate Securities, and the Investing Public" *Rate Structure Hearings* (1969); West and Tinic, *Minimum Commission Rates on New York Stock Exchange Transactions*, 2 Bell Journal of Economic and Management Science 577 (1971).

[46] *See* Friend and Blume, *supra* n. 43.

data.[47] A number of brokerage firms have repeatedly indicated that it is impractical to allocate expenses so as to break down net income among such varied lines of business as securities commissions, underwriting and trading profits since substantially the same sales personnel and branch office facilities are engaged in the generation of all sources of revenues at any time, and it is not practicable to allocate to each revenue source its share of such joint expenses as personnel costs, occupancy and equipment costs, interest and communication costs.

On the basis of its experience over the last six years with the problems of analyzing costs for a brokerage industry in many different lines of business, the Commission has concluded, as noted above, that commitment of resources would not be justified in view of the strong probability that no such system would work as well as competition.[48] The brokerage industry has demonstrated for a number of years that it can deal with price competition. Initially, such competition was confined to the use of the complex rebative practices which developed because the fixed commission rate structure was out of line with perceptions of cost. Since April, 1971, competitive commission rates for large transactions have been given formal recognition in the rate structure, and since April, 1974, competitive commission rates have been in effect for small transactions.

The second argument for retaining fixed commission rates is that they provide a number of subsidies which are beneficial to the operation of the securities markets.[49] Thus, it is said that large investors should pay

[47] *See supra* n. 22 and accompanying text.

[48] *See supra* "Reasons for the Rule."

[49] *See, e.g., Statements at Intra-Member Rate Hearings* by representatives of the NYSE, the American Stock Exchange, and the Securities Industry Association; and Satements at *19b–*

commissions which are in excess of those justified by costs thereby enabling brokers to hold commission rates for small investors down to reasonable levels. The participation of small investors, which would be encouraged by lower commission rates would, it is asserted, enhance the orderliness and liquidity of the market for securities.

Many brokerage firms, however, concentrate on servicing large institutions while others concentrate on a retail business for small investors. Firms that do both a retail business and an institutional business have tended to treat the two as separate operations; each operation is in effect selling a different product and selling it to customers with fundamentally different needs. Brokerage firms are not obligated to do business at the request of the public and may decline, for example, to handle the accounts of small customers. Consequently, revenues derived from institutional business do not provide any rational, controllable subsidies to small investors.

It has also been argued that minimum commission rates, since they provide a relatively dependable stream of revenue to regional brokers, particularly small brokers, enable them to operate profitably. Their continued existence is said to be dependent on profits derived from fixed commission rates and to be important in order to maintain a nationwide distribution network for newly issued securities as well as to provide regional underwriting capabilities for local enterprises. While it may be argued that commission rates should be kept artificially high to sustain regional brokers in times of few underwritings so that they

3 Hearings by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated; and by representatives of the Association for the Preservation of the Auction Market, Inc., the NYSE, the American Stock Exchange, and the Securities Industry Association.

may be available when needed to distribute new offerings, underwriting is recognized as profitable business for a brokerage firm, there have always been adequate resources to devote, in light of the demand, to underwriting activities and many regional brokers appear confident of their ability to operate without minimum commission rates. Nevertheless, it is possible that some firms are not large enough to operate efficiently. To that extent there may be a continuation in the current pattern of consolidation of firms after the introduction of competitive commissions.

It has also been argued that minimum floor brokerage commissions are desirable because they maintain excess capacity on exchange floors during slack periods in order to meet peak demands. There are not, however, concomitant obligations on exchanges or their members to maintain any particular level of floor brokerage capacity. Consequently, capacity is not maintained except to the extent that individual exchange members believe it desirable in order to meet expected demand.

With respect to market making by specialists, it is argued that floor brokerage income realized from high volume securities enables the specialist to make a better market in low volume securities. But it has never been possible, in the view of exchanges and specialists, to measure the quality of markets with any degree of precision so as to determine that any incentive provided by minimum floor brokerage commissions is being used to provide better markets. It has consistently been acknowledged that the type of market maintained for a security is dependent upon its individual trading characteristics which may vary from time to time so that there is not any way to monitor the use by specialists of any incentive provided. Furthermore, the system of allocating and reallocating stocks to specialists has not been designed for the purpose of distributing floor brokerage among different specialists on any basis likely to make efficient use of the incentive. Secondly, securities listed on exchanges are required to meet listing criteria designed to provide reasonable likelihood of sufficient trading volume so that the exchange system will operate effectively.

The third argument for maintaining fixed commission rates is that they provide an incentive for membership on exchanges and that the exchange revenue derived from the orders executed on exchanges supports desirable self-regulation of the brokerage industry. The advent of competitive rates, it is argued, may lead to an exodus from exchanges of members which could effectively negotiate access to the exchange when necessary and would otherwise make separate markets off the exchanges.

Market making requires the commitment of capital so that, to the extent exchanges operate as efficient market places, brokers will be less likely to make the necessary investment to engage in their own market-making activities. With respect to the possible loss of membership in the case of brokers which prefer to negotiate access to exchange facilities, exchanges have authority to provide appropriate regulation for such transactions. Furthermore, exchanges may impose revenue charges to support their activities which, if not borne directly by brokers which negotiate access, will nevertheless be passed on indirectly to them through charges made by members. If transactions in listed securities take place off exchanges to a greater extent than is now the case, the associated self-regulatory costs will be shifted to a national securities associa-

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tion. Finally, developments of this kind are among the matters which may be monitored and dealt with if they arise, as discussed below.[50]

Representatives of several exchanges, as well as several other witnesses at the *19b–3 Hearings*,[51] suggested that current economic conditions should lead to a postponement of the introduction of competitive commission rates. It is argued that the transition should be timed to a period of general prosperity so as to allow the securities industry a margin for error in making the necessary adjustments for competitive commission rates. There is not, however, any assurance of successfully predicting the general level of the economy, or of stock volume and stock prices. Furthermore, if a decision were to be made on the basis of predictions, after the decision became effective there could be a change in the trend of the economy, or of stock market volume and stock prices independent of the general state of the economy.

Similarly, there have been recent periods of high stock market volume and stock prices when it would have been unwise to introduce competitive commission rates; during the paperwork crunch in 1969 and 1970 there might have been substantial risks to investor protection, notwithstanding relatively high volume and prices for most of that period. Developments since

[50] Furthermore, with the advent of the consolidated tape, any broker choosing to make its own markets in listed securities would have to ensure appropriate reporting. *See Silver* v. *New York Stock Exchange*, 373 U.S. 341, 356 (1963), with respect to regulation by exchanges of non-members.

[51] *See, e.g.*, statements at *19b–3 Hearings* by Sanford I. Weil, Chief Executive Officer, Shearson Hayden Stone, Inc.; James M. Roche, Public Director of the NYSE; and representatives of the American Stock Exchange, Midwest Stock Exchange and the Securities Industry Association.

1970, such as implementation of the Securities Investor Protection Act,[52] revision of financial responsibility rules,[53] implementation of new rules with respect to custody of customer funds and securities [54] and improved surveillance procedures [55] have substantially reduced those risks.

On the other hand, some commentators suggested that there would be a better opportunity to observe adverse consequences, if any, and take action to correct them during a period of relative lack of activity in the industry. Finally it was suggested by others that there would be transitional problems of roughly the same magnitude whenever the transition took place, and, therefore, no effort should be made to tie the transition to particular economic circumstances.[56]

The most important consideration is that the brokerage industry should be given, as it has been, a substantial period of time to plan for the transition rather than attempt to time the change precisely with respect to particular economic circumstances. That was the principle which motivated the Commission to announce, in September, 1973, its policy conclusion

[52] 15 U.S.C. 78aaa *et seq.* The Securities Investor Protection Corporation, established by the Securities Investor Protection Act, had by the end of 1973, placed 94 firms in liquidation. Securities Investor Protection Corporation, *Third Annual Report 1973*, at 1 (1974).

[53] *Compare* NYSE Rule 325 as in effect until 1970 *with* such rule as in effect subsequently.

[54] Rule 15c3–3 under the Securities Exchange Act of 1934, 17 C.F.R. 240.15c3–3.

[55] *See* Securities Investor Protection Corporation, *Third Annual Report 1973*, at 16–17 (1974).

[56] *See, e.g.*, statements at *19b–3 Hearings* by Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University, and Roger E. Birk, President, Merrill Lynch, Pierce, Fenner & Smith, Incorporated.

that the fixing of commission rates should be terminated after April 30, 1975.

It was also urged that a number of other steps be implemented concurrently with or prior to the introduction of competitive commission rates. Suggestions included: (a) adoption of a best execution rule;[57] (b) development of a composite quotation system and improved nationwide clearance and depository system;[58] (c) possible safeguards to maintain viability of regional exchanges and third markets;[59] (d) preservation of the auction market by providing "equal regulation" for aspects of the securities business;[60] (e) alteration of other rules of exchanges which have anti-competitive aspects;[61] (f) prior action to lower costs on small transactions;[62] (g) prohibition of affil-

[57] *See, e.g.*, statements at *19b–3 Hearings* by Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University; Donald Farrar, Professor of Finance, University of California, Los Angeles; and representatives of the Boston Stock Exchange.

[58] *See, e.g.*, statements at *19b–3 Hearings* by Daniel J. Murphy, Senior Vice President, Shields Model Roland, Incorporated; and representatives of the Boston Stock Exchange, Midwest Stock Exchange and PBW Stock Exchange, Inc.

[59] *See, e.g.*, statements at *19b–3 Hearings* by Donald Farrar, Professor of Finance, University of California, Los Angeles; Mark Batatian, President, Prudential-American Securities, Inc.; and representatives of the PBW Stock Exchange, Inc., and the Investment Counsel Association of America.

[60] *See, e.g.*, statements at *19b–3 Hearings* by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated; and representatives of the Midwest Stock Exchange and the NYSE.

[61] *See* statement at *19b–3 Hearings* by Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University.

[62] *See, e.g.*, statements at *19b–3 Hearings* by Mark Kaplan, President, Drexel Burnham & Co., Inc. and Thomas E. O'Hara, Chairman of the Board of Trustees of the National Association of Investment Clubs.

iated business;[63] (h) adoption of rules to resolve possible questions as to the scope of the term "investment adviser" under the Investment Advisers Act of 1940 and of the term "member" under the Act;[64] (i) action to clarify the "fiduciary" question;[65] and (j) institution of a monitoring system to assess the impact of competitive commission rates.[66]

Some of the suggestions are intended to have the effect of preserving the competitive position of exchanges; others are designed to remove competitive disadvantages which are believed to impede the ability of existing participants in the securities markets to compete effectively without fixed minimum commissions. Still other suggestions link anticipated de-

[63] *See, e.g.*, statements at *19b–3 Hearings* by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated; and by representatives of the Midwest Stock Exchange.

[64] *See, e.g.*, statments at *19b–3 Hearings* by Roger E. Birk, President, Merrill Lynch, Pierce, Fenner & Smith, Incorporated; and representatives of the Midwest Stock Exchange.

[65] *See e.g.*, statements at *19b–3 Hearings* by Robert H. B. Baldwin, President, Morgan Stanley & Co., Incorporated; Haig Casparian, Vice President and General Counsel, William D. Witter, Inc.; Philip G. Conner, Executive Vice-President, Conner, Redwine Inc.; Roger E. Birk, President, Merrill Lynch, Pierce, Fenner & Smith, Incorporated; Daniel J. Murphy, Senior Vice President, Shields Model Roland Incorporated; Mark Kaplan, President, Drexel Burnham & Co. Incorporated; Honorable Gerald L. Parsky, Assistant Secretary of the Treasury for Trade, Energy, and Financial Resources Policy Consideration; Marshall Blume, Professor of Finance, University of Pennsylvania; James H. Lorie, Professor of Business Administration, University of Chicago; Robert Loeffler, Trustee, Equity Funding Corporation of America; and representatives of the Boston Stock Exchange, Midwest Stock Exchange, NYSE, American Insurance Association and Investment Counsel Association of America.

[66] *See, e.g.*, statements at *19b–3 Hearings* by representatives of the NYSE.

velopments in the efficient operation of the securities markets to the issue of competitive commission rates or anticipate problems with respect to the fair and orderly operation of securities markets.

With respect to adoption of a best execution rule, the Commission does not believe it necessary, solely because of the introduction of competitive commission rates, to formulate special principles to supplement existing standards as to the duty of loyalty and care owed by an agent to his principal under general principles of agency law, as currently supplemented by the provisions of the Act and the rules adopted thereunder. If, however, it should appear appropriate, after the introduction of competitive commissions and on the basis of experience with the evolution of the markets, to provide more particular rules, the Commission will consider doing so.

More efficient and wider dissemination of quotations as well as full implementation of the consolidated tape now in a trial phase, continue, in the Commission's judgment, to be appropriate in the context of the development of a central market system. In the view of the Commission the essence of the central market system is an interconnected system of communication. But the development of such a system or further improvements in the nationwide clearance and depository systems are not preconditions to the introduction of competitive commission rates; rather, competitive commission may, as suggested by some,[67] speed progress in their development.

While regional exchanges have been innovative and resourceful in developing new techniques and services for their members, some of them have also been ve-

[67] *See* statement at *19b–3 Hearings* by James H. Lorie, Professor of Business Administration, University of Chicago.

hicles for the evasion of minimum commissions. At least one regional exchange has indicated its confidence that it will be a viable marketplace without minimum commissions,[68] and the Commission does not believe it appropriate to afford special safeguards to regional exchanges solely to protect them against the effects of competitive commissions rather than for reasons relating to a desirable market structure. Similarly, to the extent that the third market has in effect existed because of the exchange umbrella of the minimum commission rate structure, the Commission does not therefore conclude that special protections are appropriate for the third market to further the objectives of the Act.

Suggestions for "equal regulation" for all aspects of the securities business came specifically from the NYSE. The NYSE would, among other things, require all trading in listed securities to be exposed to the auction market provided by any exchange[69] and would limit contact between dealers in listed securities and their customers as is currently done for specialists by NYSE and American Stock Exchange rules. The NYSE and American Stock Exchange rules restricting specialists from certain classes of customers have their regulatory foundation on the specialist's control of the limit order book from which he derives substantial income acting as an agent for other brokers. Similar circumstances do not exist for third

[68] *See* statement at *19b–3 Hearings* by representatives of the Midwest Stock Exchange.

[69] The Midwest Stock Exchange suggested requiring all trading of listed securities to be done on exchanges if exchange memberships dropped. Currently NYSE rules provide in a number of situations that a member need not take even its own transactions in listed securities to an exchange floor. *See* NYSE Rules relating to secondary distributions.

market dealers. Nevertheless, without such provisions it is suggested that the third market will expand to the detriment of the exchanges and the auction market they provide.

Other commentators have suggested that it is more reasonable to argue that minimum commission rates have had more to do with fostering the development of the third market than to argue that competitive rates will make the third market more important.[70] Since the effect of proposals to restrict third market dealers would be to put the third market out of business and consequently give exchanges a monopoly on trading in listed securities, such action would not appear to be appropriate without persuasive evidence based on experience with competitive commission rates that the objectives of the Act would thereby be promoted.

Alteration of other rules of exchanges which have anticompetitive effects was also suggested by commentators particularly concerned that regional exchanges might not survive in an environment of competitive commission rates. One commentator suggested requiring the NYSE to allow anyone to become a specialist in order to develop a system of competitive specialists on the NYSE. That suggestion is based on assumptions about future developments in the markets for listed securities as a consequence of introducing competitive commission rates; those developments may not come to pass and the Commission does not believe it necessary to take specific action in advance of any experience with actual developments.

[70] *See, e.g.*, statements at *19b–3 Hearings* by James H. Lorie, Professor of Business Administration, University of Chicago, and Seymour Smidt, Professor of Managerial Economics in the Graduate School of Business and Public Administration, Cornell University.

With respect to small transactions, it may not be possible to reduce costs without changes in the manner in which securities transactions are effected; certain kinds of costs do not vary with the amount involved in a transaction and must be incurred. To the extent, however, that better cost controls and improved procedures for processing transactions, including the elimination or immobilization of stock certificates, can be developed, their development will be speeded by the introduction of competitive commission rates and impeded by retention of a minimum commission rate system in which rates are automatically increased to pay for increasing costs.

It was also urged that, prior to implementation of a system of competitive commission rates, any handling of affiliated business by exchange members should be prohibited outright in place of the current provisions of Rule 19b–2[71] which require that 80 percent of an exchange member's business not be affiliated business. In adopting Rule 19b–2 the Commission recognized that it should gain some administrative experience in its operation and impact so that it might reassess its position should harmful, unforeseen consequences arise. The current formulation provides flexibility to respond to any fundamental changes attributable to operation under competitive commission rates, which will greatly reduce the significance of the so-called "institutional membership" problem.

The fiduciary question referred to above, arises out of the expectation by many observers that institutional portfolio managers, who purchase a very large part of all brokerage services, may believe themselves compelled, after the introduction of competitive commission rates, to seek the lowest available commission rate. It is believed that institutions would so act out of

[71] 17 C.F.R. 240.19b–2.

fear of lawsuits alleging breach of fiduciary duty if they used their beneficiaries' funds to pay more than the lowest available commission rate. Paying the lowest available commission rate would, it is argued, protect the institutional portfolio manager from liability. Fiduciaries, however, purchase other services for their beneficiaries without believing themselves compelled to seek the lowest possible cost; rather they appropriately "consider the full range and quality" of the services which accrue to their beneficiaries and "need not solicit competitive bids." [72]

In this connection, it has been suggested that fiduciaries might feel compelled to pay commissions which were so low as to make it impossible for brokers to supply research which is urgently needed by these fiduciaries and their beneficiaries. The Commission does not believe that this will occur to any material extent since fiduciaries are entitled to exercise their judgment as to what is in the interest of their beneficiaries and, in any event, the cost of research does not appear to be so large a part of the expense incurred by brokerage firms as to make it impossible for them to supply it in reasonable quantity if their customers desire it.[73] While there may be some period

[72] *Cf.* Securities Exchange Act Release No. 9598 (May 9, 1972), 37 Fed. Reg. 9988 (May 18, 1972).

[73] Member firms' 1973 NYSE Income and Expense reports (which include an estimate of research expense covering all research activities wherever performed) show that, of the 235 firms carrying public customer accounts, 4 estimated research expense as 25 percent or more of total expense, 12 or more than 15 percent, and 26 firms as more than 10 percent. The aggregate research expense of these 26 firms was $20 million out of a total of $100 million for all 235 carrying firms. There were 180 firms for which research expense was estimated to account for less than 5 percent of total expense; but the research expenditures of these firms accounted for 65 percent of the total for all carrying firms.

of adjustment for fiduciaries after the introduction of competitive commission rates for all transactions, experience has to some extent already built up in arriving at commissions on the portion of orders over $300,000, which have most frequently involved fiduciaries. That experience should eventually be capable of general application.

Questions relating to the definition of investment adviser under the Investment Advisers Act of 1940 may require analysis based on experience with competitive commission rates. The questions raised relating to the scope of the definition of member under the Act are not basically new, but were not considered to require specific action in connection with the introduction of access provisions for non-member brokers. The Commission, as indicated below, is, however, prepared to consider further specific proposals with respect to those questions as well as the fiduciary question and other suggestions made at the *19b–3 Hearings*.

The Commission was also requested to undertake a monitoring system to assess the impact of competitive commissions. The Commission proposes to take steps to provide appropriate increased monitoring of the activities of brokers, and their financial condition and operations as well as possible shifts in patterns of trading for some period subsequent to May 1, 1975, in order to assure that the objectives of the Act, including the protection of investors and the maintenance of fair and orderly markets, are upheld during any transitional phase. Such monitoring may include collection of additional financial data as well as programs of staff interviews to evaluate changing conditions. In that connection the Commission will welcome specific suggestions for the types of activities on which monitoring efforts should be focused. In addi-

tion, the Commission will consider whether or not any rulemaking or other action would be appropriate to clarify the application of the definition of member in order to assist exchanges in performing their self-regulatory role and will consider questions as to incentives to exchange membership and problems for fiduciaries anticipated by some commentators. As to the fiduciary question the Commission will, of course, also submit comments on provisions in pending legislation.[74] Any such action, if appropriate, could be taken prior to May 1, 1975, in order to facilitate the transition.

Stated differently, certain persons suggested that the introduction of competitive rates would have undesirable and unintended consequences, in part because of the changes which it would create in the economic incentives and choices of member firms. The Commission believes that these concerns appear exaggerated. In any event, however, the possibility of such undesirable consequences does not provide an adequate basis for deferring competitive rates, since there are other ways in which these problems can be dealt with. The monitoring efforts which the Commission intends to undertake will enable it to be alert to developments and to position itself to take prompt corrective action if undesirable consequences develop before, or after, May 1, 1975. Thus, for example, if it should appear that member firms are proposing to leave the exchanges in order to execute customers' transactions by making markets off the exchange, various steps could be taken to restrict this practice to the extent necessary or appropriate in the public interest or for the protection of investors.

In that connection, the Commission intends shortly

[74] H.R. 10 and S. 249, 94th Cong., 1st Sess. (1975).

to announce procedures by which any interested person may offer suggestions concerning appropriate methods to deal with any problems that might emerge. It should be noted, however, that proposals which appear on their face to be anticompetitive, can hardly be acted upon in the absence of experience under competitive rates which demonstrates that they are, nevertheless, necessary or appropriate.

4. Conclusion

After a long and careful consideration of the policy questions raised by the existence of the fixed commission rate structures on national securities exchanges, the Commission has concluded that the adoption of Securities Exchange Act Rule 19b–3, precluding exchanges from fixing the rates of commission their members must charge, is necessary or appropriate for the protection of investors, to assure fair dealing in securities traded in upon such exchanges and to insure the fair administration of such exchanges, and, accordingly, hereby adopts Rule 19b-3.

5. The text of the rule

The text of Rule 19b–3, as adopted, is as follows:

Rule 19b–3. Prohibiting Fixing of Rates of Commission by Exchanges

(a) No national securities exchange ("exchange") shall adopt or retain any rule of the exchange that requires, or shall otherwise, directly or indirectly, require its members, or any person associated with its members, to charge any person any fixed rate of commission for transactions effected on, or effected by the use of the facilities of, such exchange.

(b) Each such exchange shall provide in its rules of the exchange that nothing therein or in

its practices shall be construed to require or authorize its members, or any person associated with its members, to agree or arrange, directly or indirectly, for the changing of fixed rates of commission for transactions effected on, or effected by the use of the facilities of, such exchange.

(c) No member of any exchange, or person associated with any member, shall be required to comply with, or may rely on, the provisions of any rule of the exchange covered by paragraph (a) of this rule.

(d) As used in this rule, the term "rule of the exchange" refers to any provision of the constitution, articles of incorporation, bylaws or rules or instruments corresponding thereto, whatever the name, of the exchange, and the term "floor brokerage commissions" refers to commissions applicable to the execution of transactions for members or associate members of an exchange but does not include commissions for clearance services or commissions for a combination of floor brokerage and clearance services.

(e) The provisions of this rule shall become effective on May 1, 1975, except as to any rule of the exchange relating to floor brokerage commissions as to which the provisions of this rule shall become effective on May 1, 1976.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

Securities and Exchange Commission,
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 9351

The Securities and Exchange Commission today announced that it has sent the following letter to the New York Stock Exchange in response to the latter's commission rate proposal of June 28, 1971:

SEPTEMBER 24, 1971.

MR. ROBERT W. HAACK,
President, New York Stock Exchange,
New York, N.Y.

DEAR MR. HAACK: The Commission has reviewed the proposed commission rates submitted by the New York Stock Exchange on June 28, 1971 pursuant to Rule 17a–8 and in light of the evidence presented at the public hearing on the proposal. As the Exchange has recognized, a rule dealing with commission rates is necessarily dependent for its validity upon the continuation of the conditions and circumstances justifying the reasonableness of the rates. Accordingly, the Commission expects that the Exchange will review its commission rate structure on a regular and systematic basis and will submit any appropriate modifications or changes in such structure to the Commission to enable it to exercise its continuing regulatory oversight. The Commission expects the Exchange to con-

tinue to gather necessary data from its members for this purpose. The Commission will also continue its monitoring program in order to assess the need for any rate changes.

As regards the present rate proposal, the inability of the Exchange appropriately to allocate costs and revenues between brokerage and other activities of its members has necessitated our consideration of the proposed rates on the basis of the total financial experience of Exchange member firms. We have considered the problems experienced by the securities industry in dealing with widely fluctuating volume levels in recent years, leading to back office problems and, in some cases, the insolvency of member firms. We find that the profitability of member firms during the first half of 1971 appears to be reasonable in view of significant changes in the operation and structure of the industry, including the introduction of competitive rates on certain large transactions, the forthcoming rules to protect customers' funds and securities and greater access by nonmember broker-dealers to the facilities of the Exchange. The Commission is continuing to study the economic and regulatory impact on the investing public, the securities markets and the securities industry of competitive commission rates on portions of orders in excess of $500,000. Accordingly, we reserve this matter for later determination in light of the evidence which is being developed.

On the basis of the evidence presented to us and the factors discussed above, the Commission does not object at this time to implementation of the Exchange's proposed rates, subject to the following conditions:

1. The present surcharge on certain transactions will be terminated as to all such transactions as soon as the Exchange, consistent with price restrictions referred to in subparagraph 10, may implement the new rate proposal.

2. In order to provide small investors with the continued opportunity to participate in the securities markets, no member organization that has traditionally handled small customer accounts will impose or continue any limitation of any kind on the size or frequency of any such customer's orders or the size of his account, nor will any member organizations impose fees, commissions or other charges on any such customer in excess of the proposed rates. The Exchange will establish an Investors' Service Bureau to assist small investors to participate in the markets, and will undertake a comprehensive and continuing effort to facilitate service to the small investor.

3. The rate schedule will be revised to provide that the total commission on an order consisting of a round-lot plus an odd-lot will not be higher than the commission on the next higher round-lot.

4. The intra-member rate will be reviewed by the Exchange in order to determine whether fixed charges should continue to prevail in this area. As regards the intra-member rate incorporated in the NYSE rate proposal, the Commission does not object at this time to that part of the proposal subject to the continuing consideration and review of the long-run desirability of the continuation of fixed intra-member charges and to the Commission's consideration of the industry structure questions in the hearings commencing October 12, 1971 and to the other conditions noted below.

5. The Commission finds that the provision for 30% access is inadequate and that the discount afforded nonmember broker-dealers should be not less than 40% to allow for a minimum meaningful test of this proposal. The Commission is reserving its final deter-

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mination regarding the "primary purpose" limitation of the access provision until the completion of its scheduled hearings. The Commission will reconsider the access provision, including its "primary purpose" limitation, after the conclusion of the hearings scheduled to begin October 12, 1971. The Commission finds inappropriate the condition that it enforce the anti-rebate provisions of the Exchange's agreements for access by nonmembers. The responsibility for enforcing a rule adopted by a self-regulatory organization lies with that organization and the Commission's regulatory oversight will be exercised only to ensure that the rule and its administration by the self-regulatory organization are appropriate.

6. The Exchange will continue to ensure that commission revenues are prudently applied by all member organizations so as to improve further their capital positions and operational facilities.

7. The Exchange will, on or before May 1, 1972, submit to the Commission its proposals for implementing uniform reporting by member firms in order to permit evaluation of subsequent commission rate proposals, if the Exchange is unable to devise a suitable reporting mechanism, the Commission will consider doing so pursuant to Section 17(a) of the Securities Exchange Act.

8. The Exchange will examine its definition of an "order" to determine whether to alter the present provision so that portions of the same order executed on different days would be aggregated for purposes of ascertaining the applicable commission rate.

9. The Exchange will adopt rules or rule changes to enable member firms to enter into cooperative arrangements under which execution and clearance functions of such firms could be performed jointly without the payment of intra-member rates for such functions to any other member.

10. The Exchange will comply with any restrictions on price increases imposed by law, as interpreted by the President's Cost of Living Council or any other organization designated by the President or the Congress to impose or interpret any such restrictions.

Sincerely yours,

WILLIAM J. CASEY,
Chairman.

Before the Securities and Exchange Commission,
Washington, D.C.

FILE NO. 10-54-1

PROPOSED RULES OF THE CHICAGO BOARD OPTIONS EXCHANGE

COMMENTS OF THE UNITED STATES DEPARTMENT OF JUSTICE

THOMAS E. KAUPER,
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JANUARY 15, 1973.

The Commission has requested public comment on the proposed rules of the Chicago Board Options Exchange, Inc. ("CBOE") which is seeking registration as a national securities exchange pursuant to Section 6 of the Securities Exchange Act of 1934. In response to this invitation, we wish to comment on proposed Rule 14 which fixes minimum rates of commission for transactions executed on the CBOE.[1] We believe that this rule is subject to serious objection on antitrust and public policy grounds.

[1] Our silence with respect to the other proposed rules of CBOE implies neither approval nor disapproval.

The Commission is well aware that fixed minimum rates of commission raise serious questions under the antitrust laws. *Thill Securities Corp.* v. *New York Stock Exchange,* 433 F. 2d 264 (7th Cir. 1970), *cert. denied,* 401 U.S. 994 (1971). Based on evidence accumulated by the Commission and the courts, the Department of Justice has taken the position that fixed minimum rates are not necessary to achieve any goal of the securities laws and therefore violate the antitrust laws under the doctrine of *Silver* v. *New York Stock Exchange,* 373 U.S. 341 (1963). We have expressed this opinion in several memoranda submitted to the Commission during the last five years' commission rate and market structure proceedings[2] and have actively advocated this position as a party to the *Thill* litigation. In addition, we have filed an antitrust suit against the Chicago Board of Trade seeking injunctive relief against the fixing of minimum commission rates on that leading commodity exchange, the sponsor of the new CBOE.[3]

There is a trend toward eliminating the traditional fixed rates on various exchanges—or stated alternatively there has been no showing that fixed commissions are necessary to make any exchange system work. *Cf. Silver* v. *New York Stock Exchange,* 373 U.S. at 357. The Commission has eliminated fixed commission rates on securities transactions of large size on existing registered national securities exchanges and has promised to lower the size of the transaction subject to negotiated rates in the future.

[2] See *Memorandum of the Department of Justice on the Fixed Minimum Commission Rate Structure,* SEC File No. 4-144 (January, 1969); *Statement of the United States Department of Justice,* SEC File No. 4-147 (December, 1971).

[3] *United States* v. *Board of Trade of the City of Chicago,* Civil No. 71C2875 (N.D. Ill.).

The Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce, House of Representatives, has recommended that all fixed rates be eliminated.[4] Within the securities industry itself, a growing number of prominent persons have recommended the elimination of fixed rates.[5]

A parallel trend can be seen on the nation's commodity exchanges. Most of the larger exchanges have agreed, in settlement of antitrust suits, to phase out entirely fixed commission rates over a period of several years.[6] The Administrator, Commodity Exchange Authority, after careful study, concluded that the orderly elimination of fixed rates would prove beneficial to traders on commodity exchanges without adverse consequences to the brokerage industry.[7] A recently organized commodity exchange, at the urging of the administrator, deleted fixed minimum rates from its proposed rules.[8]

These developments suggest that it would be highly undesirable for the Commission to approve fixed commission rates on a new exchange which is about to be registered. Even if it is appropriate to allow a prompt but gradual phase-out of fixed rates on established

[4] Securities Industry Study Report of the Subcommittee on Commerce and Finance, Committee on Interstate and Foreign Commerce, House of Representatives, Aug. 23, 1972, pp. XIV; 131–146.

[5] See *Statement of the United States Department of Justice*, *supra*, pp. 6–8.

[6] See documents filed in *Arenson* v. *Chicago Mercantile Exchange*, Civil No. 71C854 (N.D. Ill.).

[7] See *A Report on the Rules and Practices of the Chicago Board of Trade Concerning Minimum Rates of Commission and Brokerage Fees*, Administrator, Commodity Exchange Authority July, 1972.

[8] See Rules of the Pacific Commodities Exchange, Inc. on file with the Commodity Exchange Authority.

exchanges, this cannot justify present approval (or non-disapproval) of fixed rates for exchanges not yet in existence. Such a course would be plainly contrary to the broad public interest in a competitive economy. See *U.S.* v. *Philadelphia National Bank*, 374 U.S. 321, 372 (1963); *Thill; supra.* It would also—unwisely—expose the members of the CBOE to possible treble damage liability under the antitrust laws. While there may be some question about the appropriateness of such damages for long established practices of existing exchanges,[9] no considerations of laches, estoppel or reliance would be present in the case of the CBOE.

We therefore request that the Commission disapprove proposed Rule 14 of the CBOE on the ground that it unnecessarily interferes with competition. Cf. *Thill*, 433 F. 2d at 271–2; *Rules of the New York Stock Exchange*, 10 S.E.C. 270 (1941). In the alternative, if it grants approval, (or non-disapproval), we request that it formally notify the Department of Justice of (i) the reasons for its action, and (ii) the legal status of the rule under the securities laws. See *Ricci* v. *Chicago Mercantile Exchange*, (Supreme Court, Jan. 9, 1972) slip opinion, p. 15, fn. 14.

THOMAS E. KAUPER,
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DONALD I. BAKER,
BARRY GROSSMAN,
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Attorneys,
Department of Justice.

JANUARY 15, 1973.

[9] See Comments of Judge Swgert in *Thill*, 433 F. 2d at 277.

Securities Exchange Act

Release No. 9985, February 1, 1973

In the Matter of the Chicago Board Options Exchange, Inc.

FINDINGS AND OPINIONS OF THE COMMISSION

The Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange"), a Delaware non-stock corporation organized to establish an auction market dealing in put and call options, filed with us an application for registration as a national securities exchange pursuant to Section 6 of the Securities Exchange Act of 1934 ("Exchange Act").[1] In response to public notice of the filing of the application and our invitation for comments thereon, certain comments were submitted to us by the American Stockholders Association, Inc., the American Stock Exchange and the Antitrust Division of the United States Department of Justice, all of which have been carefully considered.

Under Section 6(d) of the Exchange Act we are required to cause an exchange applying for registration to be registered as a national securities exchange if it appears to us that the exchange is so organized as to be able to comply with the provisions of the Act and the rules and regulations thereunder and

[1] Pursuant to the Exchange's consent, action on its application as amended has been deferred pending the issuance of these findings and opinion.

that the rules of the exchange are just and adequate to insure fair dealing and to protect investors.

After a review of CBOE's application in accordance with these standards, we have determined to grant the registration of the Exchange. In taking this action, we note that the CBOE will not be able to commence exchange operations immediately, since it appears that it will first be necessary for the Exchange (or its subsidiary, The Chicago Board Options Exchange Clearing Corporation, which is the issuer of the options to be traded on the Exchange) to effect compliance with the registration requirements of the Securities Act of 1933 and of Section 12(b) of the Exchange Act with respect to the securities for which it proposes to provide an exchange market. Exchange officials are engaged in discussions with our staff with a view to such compliance, the CBOE has agreed to make appropriate filings pursuant to those provisions, and the Exchange's application for registration includes as one of its "stated policies"[2] that it will comply with the registration provisions applicable to the securities to be traded on the Exchange.

We do not believe it is necessary to describe herein the rather voluminous rules and representations of the Exchange which have been filed with us as a part of its application. We do believe, however, that special mention should be made of several of the policy issues considered by us in connection with our review of the CBOE application.

1. Since the CBOE is a new exchange, and the first national securities exchange proposing to provide for

[2] Rule 17a–8 under the Exchange Act, which requires any proposed changes in exchange rules to be submitted to us before being put into effect, defines "rules" to include an exchange's "stated policies."

the trading of puts, calls, or similar options, we have determined to permit it to test the market for such options within a controlled environment. CBOE has stated that it intends to commence operations as a "pilot project" and limit trading on its floor initially to call options in respect of approximately 30 underlying stocks, and increase the number of underlying stocks gradually and extend operations to other types of options as experience is gained and the market and its regulatory arrangements are tested. Also, the Exchange has provided in its rules that the securities underlying the call options must be registered and listed on another national securities exchange and have broad distribution and volume characteristics.[3]

The Exchange has further agreed not to extend its activities to include trading in put options without complying with applicable procedures governing the adoption of new rules by national securities exchanges. These representations and policies announced by the Exchange are, in our view, "rules" of the Exchange and as such will be subject to our review prior to any material change therein. In this connection, we have recently proposed adoption of Rule 9b–1 under the Exchange Act which would provide special procedures relating to the adoption and alteration of rules of registered national securities exchanges concerning "acts or transactions in options."[4] In any event, we intend to maintain close surveillance over the progress of CBOE's "pilot project." For the period of CBOE's experimental status, and in line with the need to maintain flexibility in regulating this new kind of exchange

[3] CBOE Rule 5.3.

[4] Securities Exchange Act Release No. 9930 (January 9, 1973).

market,[5] we have also decided to postpone a definitive determination as to whether CBOE should be required to include in its rules a nonmember access provision.[6] CBOE rules do not now include such a provision.

2. We have also considered the question of CBOE's rules regarding fixed commission rate charges. Under Chapter XIV of its rules, CBOE has adopted a policy of permitting negotiated commission rates on all orders to purchase or sell options having premiums above $30,000, and on orders for exercise of exchange options having a value of more than $30,000 (as measured by the striking price multiplied by the number of shares). It has been suggested by one commen-

[5] As we stated in our release announcing proposed Rule 9b–1: "The Commission is of the opinion that in addition to the novelty of exchange option trading, such trading may involve complex problems and special risks to investors and to the integrity of the marketplace. The Commission therefore believes that, utilizing the broad power granted under Sections 9 and 23 of the Act it should provide itself with a substantial amount of flexibility in carrying out its regulatory responsibilities with respect to option trading on exchanges." [Footnotes omitted.]

[6] "Nonmember access" involves the granting of a percentage discount from the fixed exchange commission rate to nonmember brokers when they trade as agents in listed securities through members on that exchange. Rules providing for such access have been adopted by the other national securities exchanges. Those exchanges do not at present trade in put and call options. We also note that the adoption of nonmember access rules by those exchanges was occasioned mainly by the fact that a great many nonmembers who wished to effect transactions for their customers in listed securities were economically inhibited from doing so by prior exchange rules which prohibited their sharing in the stock exchange commissions generated. If CBOE's experiment is successful and a similar desire for access by nonmembers develops, we will reconsider the question of whether it is appropriate for CBOE to adopt a nonmember access rule.

tator [7] that we should not approve CBOE's rules unless they also provide for negotiated commission rates below the $30,000 level.

In reviewing CBOE's registration application, we have weighed its particular rule provisions against the regulatory objectives of the Exchange Act. Among other things, those objectives embody the concept that exchanges will deal fairly with the public; that exchanges will be organized in such a fashion as to ensure their continued viability in asserting self-regulatory oversight over their members; and that exchanges may, so far as is consonant with other regulatory objectives of that Act, maintain competitive viability with other exchanges. Applying these criteria, we find it in the public interest to declare effective the registration of CBOE on the basis of its present rules, including its rule regarding commission rate charges.

We have been engaged for some time in a painstaking review of the commission rate structure of all national securities exchanges. As a result of that review, we have concluded that fixed commission rates on institutional-sized orders no longer serve any compelling regulatory objective of the Exchange Act and have required each of the existing exchanges to expand the permissible negotiation of commission rates to that portion of securities orders exceeding $300,000.[8] We also have indicated our intention to consider whether this breakpoint on negotiated commission rates should not be lowered to $100,000 provided our analysis of the impact of negotiation of commission rates on orders exceeding $300,000 does not evidence significant regulatory problems.[9] We conclude that CBOE's re-

[7] The Antitrust Division of the U.S. Department of Justice.

[8] See Securities Exchange Act Release No. 9950, pp. 96–108 (January 16, 1973).

[9] *Ibid.*

quirement for negotiation above $30,000 is comparable to the general requirement of negotiated commission rates we previously have enunciated and comports with our general finding that negotiation on large institutional-sized orders is appropriate in the public interest. As we continue our review of the appropriateness of further reductions in the breakpoint for negotiated rates, CBOE will be included in any determinations we may make. In view of these circumstances, we do not find CBOE's proposed rule relating to rates to be unreasonable.

Recognizing CBOE as an experimental project, we believe it would be unwise, at the outset, to cast CBOE into a preconceived mold. We believe it is appropriate, therefore, pending further conclusions regarding the viability of existing fixed commission rates and the nature of CBOE's actual operations, to permit CBOE to structure its commission rates in a manner analogous to those provided by all of the existing exchanges.[10] For these reasons CBOE will be permitted to begin operations with the prevailing exchange practice of fixed minimum rates on portions of orders below an appropriate breakpoint incorporated in its rules.[11] It is understood that CBOE's fixed rates shall continue only so long as they exist on other exchanges and that the breakpoint at which

[10] We previously have enunciated our view that the structuring of a central market system is appropriate in the public interest and that such a system may require a large measure of uniformity. With the advent of increased interest in trading in options, it is difficult to predict what, if any, role in such a central market system CBOE will play. But we do not believe it is appropriate to *mandate* differences in treatment of such fundamental matters as commission rates until further experience with the CBOE pilot project is obtained.

[11] CBOE Rule 14.3.

competitively determined rates begin shall be appropriately adjusted when breakpoints lower than $300,000 are adopted by other exchanges. We are of the opinion that this approach is consistent with the standards of the Exchange Act.

We note that, in connection with the registration of CBOE (and the reported consideration also being given by certain registered exchanges to trading options), we have recently issued three releases proposing new Rule 9b–1,[12] discussed above, and Rule 12a–6,[13] and proposing an amendment to Rule 3a11–1 [14] under the Exchange Act.

Proposed Rule 12a–6 would provide an exemption from the registration provisions of Section 12(a) of the Exchange Act for securities underlying options where the option is itself registered on the national securities exchange in question, the underlying security is registered and listed on another national securities exchange, and the exchange upon which the option is listed limits its activity in the underlying securities to effecting exercises of the options. The proposed amendment to Rule 3a11–1 would clarify the term "equity security" to specifically include calls and puts.

An appropriate order granting exchange registration will issue.

By the Commission (Chairman Casey and Commissioners Herlong and Loomis); Commissioner Owens dissenting.

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[12] Securities Exchange Act Release No. 9930 (January 9, 1973).

[13] Securities Exchange Act Release No. 9931 (January 9, 1973).

[14] Securities Exchange Act Release No. 9929 (January 29, 1973).

ORDER GRANTING REGISTRATION AS NATIONAL SECURITIES EXCHANGE

The Chicago Board Options Exchange, Inc., having filed an application with the Commission for registration as a national securities exchange pursuant to Section 6 of the Securities Exchange Act of 1934; and

It appearing to the Commission that the rules of said exchange provide for the expulsion, suspension or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade and declare that the willful violation of any provisions of the Act, or of any rule or regulation thereunder, shall be considered conduct or proceeding inconsistent with just and equitable principles of trade; and

It further appearing that said exchange is so organized as to be able to comply with the provisions of said Act and the rules and regulations thereunder, and that the rules of said exchange are just and adequate to insure fair dealing and to protect investors;

It is ordered that the application of The Chicago Board Options Exchange, Inc. for registration as a national securities exchange be, and it hereby is, granted.

By the Commission.

U.S. GOVERNMENT PRINTING OFFICE: 1973